THEME ARTICLE

Intentionally Diverse: The Highly Effective Board of the Future

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For most of the last century, discussions of diversity in boardrooms were non-existent, except for those premised on the credentials of men eligible for the seats. Most commonly, diversity in boardrooms in this period arose when a rare female gained a directorship due to familial connections, such as Clara Abbott—one of the first women to serve on the board of a major corporation, Abbott Pharmaceuticals in 1900. It was not until 1985 that the average Fortune 500 company added their first independent female director. Since then, the discussions of board diversity in countries around the world have evolved in ways that were previously unimaginable. *(Stanford Graduate School of Business, Pioneering Women on Boards, 2013)*

According to a February 2022 Deloitte study of 10,493 companies in 51 countries, women hold 19.7% of these board seats. This progress is inconsistent across jurisdictions—North America and Europe lead over Asia Pacific, the Middle East, Africa, and South America—and often reflects a combination of mechanisms prompting change alongside societal priorities and cultural aspects. In countries with legal requirements related to board gender diversity, France, Norway, and Italy have the highest percentage of female directors at 43.2%, 42.4%, and 36.6%, respectively, while six other countries with quotas have not yet reached 20% female representation; of these, India leads at 17.1%, and South Korea has only 4.3% female directors *(Deloitte, Women in the Boardroom: A Global Perspective, 2022)*

Women, albeit ironically, were the first "diversity group" in the movement for improving representation on boards; however, the considerations of diversity are expanding to race, ethnicity, LGBTQ+ identification, age, and geographical provenance, among other factors. The United States has seen an acceleration in considerations on racial representation on boards, precipitated by social movements for racial equity that gained significant public support in 2020. This raises the notion that a prompt for one type of change can create the space for others. Greater open-mindedness invites more evolved thinking.

Broader and more accelerated progress occurs when there are multiple impetuses for change. Meaningful advancement requires measures for progress and mechanisms for accountability. All pathways to creating diverse boards should be utilized to address the challenges that exist within each jurisdiction. Legislatively required quotas are one of the preeminent drivers of improving board diversity. The most notable example is the recent European Union agreement to require a 40% female gender representation on non-executive boards of EU-listed companies in the 27 member countries by 2026, 9 of which currently have legislation regarding gender representation on boards. Similar quota requirements exist in other places around the world, such as Argentina, California, India, Morocco, and UAE, among others. A similarly important mechanism is disclosure requirement, often coupled with a recommendation for diverse directors. These may be driven from a nation/province/state, stock exchange, or other

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regulating body. Nasdaq is the largest stock exchange to adopt a board diversity disclosure rule. It will impact the thousands of companies listed on Nasdaq's stock exchange, providing greater transparency to investors and promoting increases in the number of diverse directors serving on these companies. The Toronto Stock Exchange and Australian Securities Exchange have similar requirements as do the United Kingdom, Finland, Sweden, and other countries, all of which have been successful in promoting board diversity *(Council of the European Union, Council and European Parliament agree to improve gender balance on company boards, 2022)*

Boards face pressures from two other key groups. Importantly, institutional investors and proxy advisors have established policies to promote board diversity. BlackRock, State Street Global Advisors, Vanguard, and other investors have policies recommending to vote against directors if the board does not meet diversity standards. Goldman Sachs will only take a U.S. or Western Europe company public if it has two diverse directors. Glass Lewis and ISS recommend voting against governance committee chairs if certain diversity minimums are not met. Boards have been highly responsive to the pressures of these organizations because of the direct impact on each board and potential implications on their companies' stock value *(Blackrock, Our Approach to Engagement on Board Diversity, 2021; State Street Global Advisors, Guidance on Diversity Disclosures and Practices, 2022; Vanguard, Global Investment Stewardship Principles, 2021; Goldman Sachs, Board Diversity in the Boardroom, 2022; Glass Lewis, Approach to Diversity Disclosures, 2021; Institutional Shareholder Services, Proxy Voting Changes for U.S., Canada, Brazil, and Americas Regional, 2021)*

Finally, directors have recognized the risk the board creates by neglecting to evolve its composition, or alternatively, the excellence they can achieve when thoughtfully forming the right group and enabling each member to drive positive impact for their stakeholders. The Business Roundtable Principles of Corporate Governance exemplify the philosophies of directors and business leaders, derived from their experience and understanding of how their corporations have benefited from diverse boards *(Business Roundtable, Driving Diversity in the Boardroom, 2022)*

Conversely, many of the boards who have experienced most recent examples of corporate governance failures—Boeing, Wells Fargo, Volkswagen, Equifax—all raise the question of where the board was in identifying and preventing the failure. Did they not recognize and appreciate the risk, or were directors unwilling to prevent management from making major mistakes that would jeopardize the company? These questions highlight the importance of board culture and composition.

When thoughtful composition and constructive culture combine, a board can foster a better exchange of ideas, leading to better decision making. Savvy boards are meaningfully assessing how to establish balanced composition and understand that greater cognitive diversity prevents risk and fosters an environment where more creativity and innovation can be achieved. Well-intentioned but non-diverse boards have blind spots. Discussions among sophisticated directors extend beyond the surface-level aspects of diversity to uncover aspects of bias in each individual and in the group as a whole. They create new paradigms for highly effective boards.

A highly effective board embraces the expectation and reality that directors should have differing experiences, profiles, and ways of thinking, because there is a natural inclination to question and explore topics. Diverse boards have intellectual curiosity as an inherent trait. They more freely explore the questions, "Is there a different (better) way that our business can operate? Is there something else that the business could do that would benefit our stakeholders and corporation?" This reflects an innate focus on matters of strategy and risk that drive and increase the chances for long-term success. The importance a board places on diversity resonates throughout a corporation from values and priorities perspectives. Under the governance of a diverse board, a commonality emerges that diversity is a main driver of value creation and the success of the business, which in turns attracts employees and customers alike.

Although progress toward diversity is differentiated, around the globe, boards are moving toward a future where a highly effective board will be based on embracing a holistic understanding of diversity. These boards will engage in regular, multi-faceted refreshment exercises that help drive meaningful engagement and robust evaluation of business options and risks. Diversity and inclusion in the boardroom should be viewed as competitive advantages and enablers of growth for any board and business that want to remain relevant for generations to come. Conversations on board composition should evolve to reflect that people are multifaceted and societies are dynamic and evolving. The boards of the future must embrace the notion that the non-conformist director should become the norm. ■

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