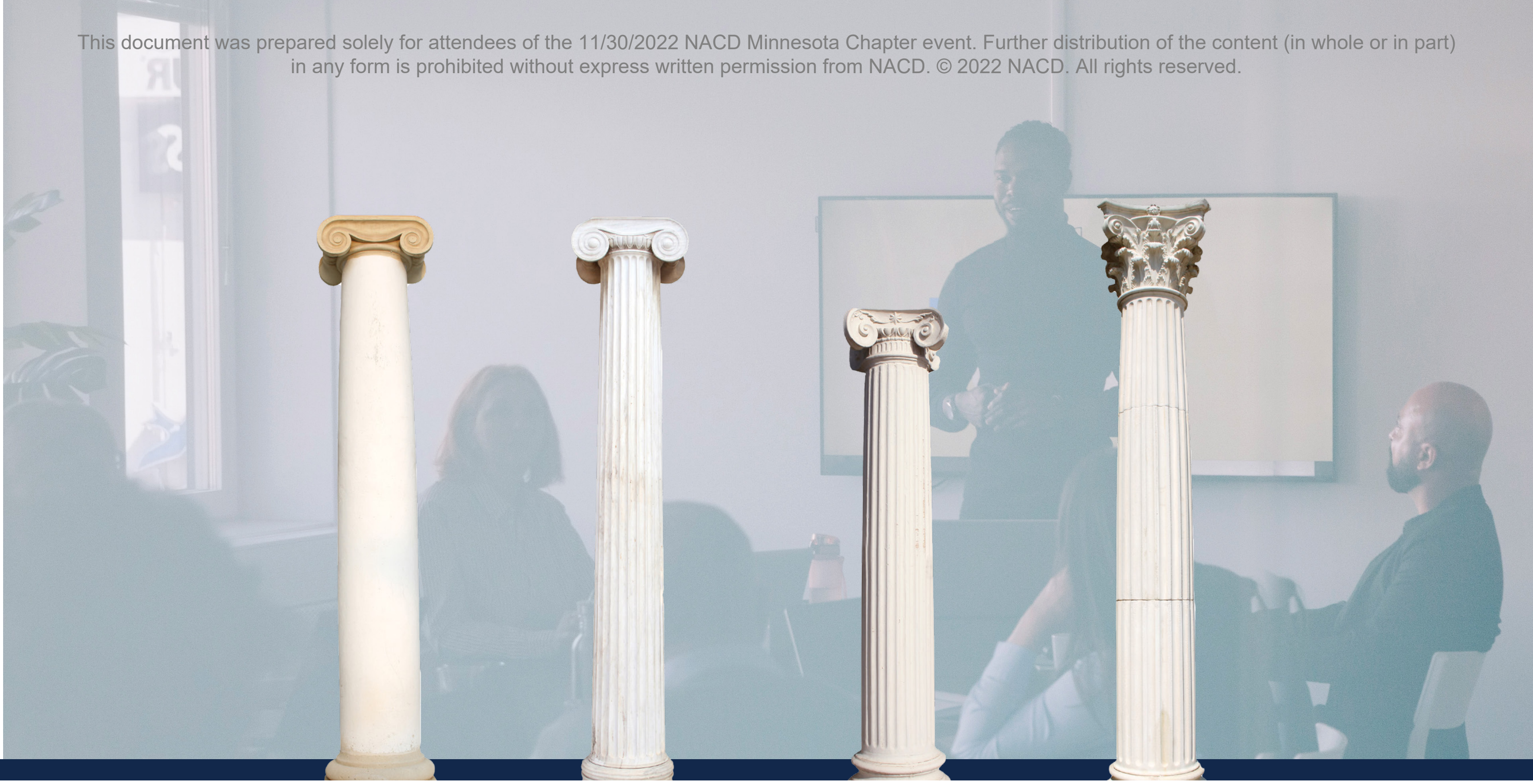

The Four Pillars of Board Diversity

By Barbara Butts Williams and Jim Zuehlke

The call for board diversity is growing louder. In 2020, social unrest magnified the need for equity, inclusion, and social justice. Nasdaq as well as the states of Washington and California responded by pushing these conversations to the forefront and pursuing board diversity mandates. Amid this societal shift, numerous studies have revealed the benefits of having diverse directors in the boardroom. To demystify how corporations can and should use diversity for better governance, let's delve into the four pillars of board diversity: gender, age, geography, and race.

BENEFITS OF DIVERSITY

While most boards focus on shareholder value, diverse directors also reflect something equally significant: stakeholder value. Stakeholders are individuals and groups that are directly affected by and impact the organization, such as shareholders, employees, customers, suppliers, communities, and the government. When a board accurately reflects its stakeholders, the board will be interested in the organization's financial performance as well as its long-term success and sustainability. This accurate and diverse representation leads to numerous benefits. In fact, we go as far as to say that diversity among directors that mirrors the organization's stakeholders is crucial for success and maximum board performance.

On a homogenous board, there can be an abundance of blind spots. Directors of the same gender, age, geography, and race will likely come together with a more unified set of experiences, bring similar approaches to problem-solving, and represent only a portion of their stakeholders. With these shared perspectives, it can be challenging to acknowledge blind spots on the board, and it can become easier to ignore the need for turnover.

Studies have identified that increased diversity directly correlates to better board performance and increased revenue year over year. Overall, board diversity has several benefits, and each pillar brings something vital to the table. However, before diving into each pillar and its benefits, it's important to understand what diversity actually means.

GETTY IMAGES

GETTY IMAGES

WHAT DIVERSITY IS NOT

It is not enough to have an assortment of demographics in a boardroom. A board must have directors with diverse thoughts, experiences, backgrounds, and skills to properly reflect the company's stakeholders. Unfortunately, this is often mistaken for the diversity of physical traits, ignoring the need for cognitive diversity.

Hiring directors based on their gender, age, geography, or race without considering their backgrounds and experience is like checking a box. It satisfies a diversity "requirement," but that doesn't mean it will benefit a company in the long term, especially if these directors are not treated as equals in the boardroom. Nasdaq's Board Diversity Rule has some tempted to "check the box" to meet regulations, but we think boards are responsible for doing more.

Recruiting diverse board members is an opportunity to identify and address weaknesses in a board by finding candidates whose backgrounds are more representative of the organization and its stakeholders, strategy, and industry. While demographic diversity alone may not create the necessary environment for better governance, cognitive diversity with directors of diverse races, ages, genders, and geographies can.

WHAT BOARD DIVERSITY IS

Board diversity is made up of four pillars: gender, age, geography, and race. Understanding what each pillar includes will help boards understand the value of cognitive diversity and give boards greater intentionality with their board search and assembly process.

Gender

Over the past two years, we've seen a slight increase in gender diversity, with women representing 21.9 percent of board members in the Russell 3000 in 2020 and 24.4 percent in 2021. In addition, boards with more women are seeing an increase in performance and revenue.

Women drive 70 percent to 80 percent of purchasing decisions, and their choices are often based on different factors than men's. Significantly fewer men have been enrolling in secondary education since 2012, while women have been steadily enrolling in colleges and universities and completing their degrees for more than a decade. According to the National Center for Education Statistics, women received nearly 58 percent of bachelor's degrees, 64 percent of master's degrees, and 56 percent of doctorate degrees in 2018–2019. Due to the influence of women on various markets and within the workforce as a result of their buying power and higher education, having women represented on the board can increase the board's accurate reflection of its stakeholders.

Studies also find that boards with more balanced gender representation see a boost in effectiveness. Women are more likely to attend meetings and come prepared, which has shown to influence their male counterparts. Women are also more likely to hold CEOs accountable for poor financial returns and hold positions on monitoring committees. Additionally, women are more likely to pursue environmentally responsible practices and inspire career development for women in lower positions within the organization. Based on these few reasons, it's easy to see why gender is a foundational aspect of board diversity.

Age

When a company goes out to recruit new directors, there is undeniable value in finding experienced candidates. Directors should have a thorough background in the industry, have a long list of valuable contacts, and bring a knowledgeable perspective that represents stakeholders. However, we often see this valuable emphasis on experience be mistaken for candidates within a certain age range.

In the Equilar 500 between 2014 and 2019, the median age of directors was 63 years old. Only 6 percent of younger directors, those 50 or younger, hold seats on S&P 500 boards. A little over half of these are younger than 47 years old. With more than 67 percent of the general US population roughly 57 years old or younger, younger directors are needed to help represent the majority of stakeholders.

While more than 30 years of experience in the industry is valuable, you don't always want to wait until the end of someone's career to get their advice. More than 95 percent of young directors actively engage in their industries through their jobs, making them more in touch with current industry trends and with contacts that could benefit your board. In addition, their unique visibility into new innovations and technology may allow them to think ahead and offer a fresh perspective for critical problem-solving.

Adding younger directors to the board helps leverage the wisdom of multiple generations, allowing members to learn from the past and propel the organization into the future.

Geography

It's often heard in the board search community that geography is the most overlooked pillar of diversity. Companies are most comfortable recruiting from where they started due to familiarity and ease. Depending on the organization's size, they often choose directors from the same city, region, or country of their headquarters. But for multiregional, national, or international companies, lacking a geographically diverse board of directors means lacking visibility into where you do business.

The first way to address this is to recruit directors in the regions and countries where you already do business. This way, the organization can increase visibility, develop better operations in these markets, and gain pivotal contacts. The second way to leverage this is during times of growth: business is done differently in different places, so you can't properly move into a market you have no experience in. By recruiting someone from the region where the organization wants to expand, who has the relevant industry experience and contacts, you will have a more successful launch and a higher chance of sustained success.

There are benefits outside of increased local visibility as well. For example, directors who are geographically remote from headquarters tend to be more mindful because they rely on hard information, such as stock prices, to keep them as well as their local counterparts informed.

All too often, however, there is pushback about pursuing geographically diverse directors. Excuses such as "It will cost too much to fly them in," and "It would make scheduling meetings too complicated," are the most frequent, but these logistical hurdles are easily budgeted and accommodated. From our experience, the benefits far outweigh the logistics discomfort and often pay off quickly.

Race

Most public company boards are primarily white and made up of men. Even with a more gender-balanced board, only 18 percent of women directors are not white. In the S&P 500, 21 percent of directors are Black or African American, Hispanic or Latino, Asian, American Indian or Native Alaskan, or multiracial. According to the US Census Bureau, the American population for most of the aforementioned racial groups has increased, meaning diversity is expanding naturally and becoming more commonplace. For any organization that operates internationally, the results seem obvious: most international organizations with boards based in the United States have an inaccurate representation of their stakeholders by not having geographically diverse directors.

Could you successfully move into a market culturally and racially different than your own? Possibly. But is it sustainable? Without directors that reflect the stakeholders and know that market, how can you truly understand it or adapt to its trends?

A white, 63-year-old man can hear about the effects of racial differences, but there is a barrier to how much he can understand without personally experiencing it. Even for the amount he can understand, he cannot represent that subset and often fumbles when trying to serve it properly. It isn't enough to hear the differences. We have a responsibility to understand them as deeply as possible. Furthermore, we should be held accountable to bring those who do understand from personal experience into our boardrooms so that they can lead as directors in making critical decisions.

Mellody Hobson, co-CEO of Ariel Investments and chair of Starbucks Corp., said it well on April 21, 2021, in a virtual talk at Bowdoin College in Maine: "You can't be a leading company in the world and not have a diverse board or have a real agenda around diversity without at some point dying as an organization."

In 2020, S&P 500 companies with boards composed of at least 30 percent non-white directors experienced an average of 54 percent year-over-year revenue growth. Utilizing race as a pillar of diversity provides a more intimate understanding of stakeholders, new perspectives on issues at hand, a broader network of contacts, reduced blind spots across industries, and increased performance that we cannot ignore.

MOVING FORWARD

Board diversity is our best tool for instating better board govern[1] ance. Boards with multidimensional diversity have thrived in recent years and even experienced growth throughout the pandemic, according to *Lessons From the Pandemic: Board Diversity and Performance*, a 2021 BoardReady report.

We have seen increased diversity in age, race, gender, and geography in recent years. It is better than it was, but our goal is not to be better than our past. Adding board diversity is our chance to continually improve, to achieve greater understanding and growth for our future. We have enough data to see the benefits of the four pillars of board diversity in action. We also have the responsibility to strive for more deliberate board diversity so that we can deliver better results for our organizations and our world. D

Barbara Butts Williams is an experienced board director and the executive dean, social responsibility and community engagement at Capella University. Jim Zuehlke is the cofounder and president of Cardinal Board Services.