Political Pressure Builds for Companies to Increase Board Diversity

Is the check-the-box approach to board diversity a push in the right direction?

BY DOUG RAYMOND

The New York City Comptroller Scott Stringer, together with New York City pension funds, launched its Boardroom Accountability Project in 2014, and it's been reasonably successful.

Now Stringer has his sights on boardroom diversity.

The 2014 effort put pressure on public companies to give their shareholders the right to include, in the company's own proxy statement, a shareholder's nominees for director alongside the board's nominees. Without this, shareholders seeking to elect a director who was not part of the management slate must incur the expense of preparing and sending separate proxy materials, which are often ignored by other shareholders.

Giving shareholders the right to have their candidates appear in the company's proxy statement alongside the management slate, a process known as "proxy access," has been directed at increasing the leverage of shareholders and, frankly, encouraging more contested director elections. The proxy access movement has, in general, been premised on the belief that making it easier for shareholders to run alternate candidates for the board will increase the quality of corporate governance, at least by causing boards to look more carefully at their own nominees as they try to ward off potential challenges.

This effort has been reasonably successful, as today over 440 companies, including over 60% of the S&P 500, have adopted some version of proxy access.

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Apparently encouraged by this, Stringer recently rolled out phase two of his campaign, this time focused on board diversity and qualifications. The "Boardroom Accountability Project 2.0," is designed to enable shareholders to better "…assess how well-suited individual director nominees are for the company … and identify any gaps in skills, experience or other characteristics, [so that shareholders may] more fully exercise our voting rights."

Presumably, this will also increase the willingness of shareholders to nominate an alternate slate.

In the first wave of this campaign, the comptroller, again together with the NYC pension funds, called upon over 150 public U.S. companies to provide an annual chart listing the race and gender of their directors, as well as each director's "most relevant skills, experience and attributions."

This requested chart and additional information regarding the diversity and gender composition of their boards would be released every year, in the form of a "board matrix," a check-the-box box format highlighting areas such as gender, race, sexual orientation (including non-binary), and skills such as international, marketing/sales, technology/systems and environmental science/policy/regulation. This matrix would be in addition to the existing SEC-required proxy statement disclosure of the qualities sought by the board in considering nominees for director, as well as descriptions of the qualifications of sitting directors.

It is hard to argue with the proposition that diversity of skills and background contributes to better boards. Despite the preponderance of older white men on corporate boards, both experience and academic research strongly support the conclusion that a meaningful diversity of perspective and experience create significant advantages in making better decisions. Further, while most highly functioning boards possess both, for many boards the transition to a more diverse board is a slow process.

The new Boardroom Accountability Project 2.0 initiative is likely to accelerate the push for increased diversity in considering board composition, and will likely lead to a flurry of shareholder proposals along these lines. However, boards should seek directors with wisdom and experience, not merely those with particular resumes.

Directors should anticipate how they are seen by their shareholders, and be prepared to explain why and how their board has — or is recruiting — the breadth of background, diversity of perspective and skills needed to lead their company and face the specific challenges confronting them.

By focusing on breadth of expertise, as well as race and gender, with the expectation that boards should choose a director from each column, the comptroller's initiative seems to sidestep the more important need for each board to make meaningful and thoughtful recruitment decisions based on their own particular situation and needs.

While boardroom diversity resonates with the investor community, a one-size-fits-all approach is not a substitute for the exercise of judgement. Directors should instead carefully evaluate the board's strengths and weaknesses, as well as its blind spots and areas where increased diversity of opinion or background would be important. While this type of soul-searching might result in some sort of summary checklist of needs, or even a matrix of attributes already represented, it is the board's analysis, not the resulting matrix, which matters.

This new phase of the boardroom accountability project sends a signal, which is being echoed by other large institutional investors such as Vanguard and Blackrock, that companies should expect board diversity and refreshment to become even more important topics in the upcoming proxy season.

Accordingly, directors should carefully consider how to respond to this increased focus, and whether they are satisfied with the level of diversity and breadth of expertise and skills currently represented in their boardroom. Equally important, directors should anticipate how they are seen by their shareholders, and be prepared to explain why and how their board has — or is recruiting — the breadth of background, diversity of perspective and skills needed to lead their company and face the specific challenges confronting them.

This type of meaningful dialogue is a much more effective way to engage shareholders and affect thoughtful progress on the issue — not a skills or race/gender checklist. ■

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