

Board Leadership and Diversity: More Action. Less Talk. What Will it Really Take to Drive Meaningful Change?

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As protests in response to racial injustice erupted across the United States and around the world in late spring, many corporate leaders and directors responded by speaking out publicly. Today, there is an expectation for CEOs and directors to do more than speak out.

Combined with the rise of environmental, social, and governance (ESG) investing, the growing acceptance of the implications of stakeholder capitalism and a global pandemic are challenging corporate leadership and boards to do even more to effect lasting change. Today there is heightened public scrutiny and an increased focus on not only the importance of racially and ethnically diverse talent within organizations, but also the racial and ethnic diversity of the board of directors. Investors and stakeholders are demanding companies move beyond diversity statements and toward strategic, concrete actions with demonstrated results to increase racial and ethnic diversity.

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While some corporate boards have prioritized gender diversity as part of succession planning efforts to choose candidates for board seats, racial and ethnic diversity have not received the same attention. Will the renewed focus on racial equality, public scrutiny, calls for transparent disclosure of accurate data, and the possibility of quotas drive meaningful change in the composition of corporate boards?

Every board has its own dynamic. It is extremely important to have the right kind of

leadership “leading leaders” to go beyond “words” and truly improve on diversity. To make an impact and effect lasting change,

boards should proactively hold themselves accountable for intentional action into progress regarding diversity in the boardroom.

Leadership Starts at the Top

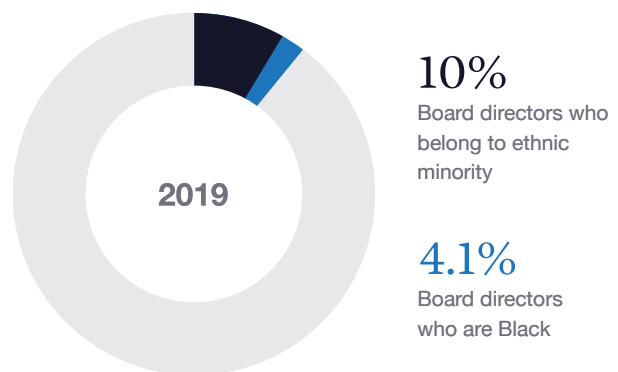
Corporate diversity and board diversity go hand in hand. As of September 2020, there were only four Black CEOs in the *Fortune 500*. If companies seek to achieve greater diversity, the work must start with the board. The heightened focus on racial and ethnic diversity and pressure to implement meaningful change presents an opportunity for corporations and boards to distinguish themselves and take a leadership role.

Attention, resources, and legislation have been committed to improving gender diversity, and significant progress has been made, with female directors reaching a record 20.4% of director seats on the *Russell 3000 Index*, according to the Gender Diversity Index report.¹

The same progress has not been achieved when racial and ethnic diversity is considered – the rate of change is substantially slower. According to the Harvard Law School Forum on Corporate Governance, in 2019 45%

of new directors in the *Russell 3000 Index* were women (46% of the new class of S&P 500, 432 in total),² while only 15% of new directors were ethnic minorities. In addition, in 2019, only 10% of *Russell 3000 Index* board directors belonged to an ethnic minority group, up from approximately 8% 11 years prior in 2008, according to the same Harvard study. The number of Black directors, specifically, stood at 4.1% in 2019.

Russell 3000 Index 2019 Director Diversity Numbers



The Harvard Law School Forum on Corporate Governance

¹ Gender Diversity Index, 2020 Women on Boards, 2019

² 2019 S&P 500 Index

Boards can expect to be criticized for a lack of diversity and for having similar board members, with similar backgrounds, geographical location, education, and networks. A willingness and interest in diversity does not equal results. To show action with demonstrated results, boards must have available openings. There is still legacy thinking that board service is for a lifetime and a lack of willingness to have the “difficult conversation” to transition a fellow director and “friend” off the board. Even with tenure limiting mechanisms, retirement age limits or maximum

terms of service, many directors still look at board appointments as “lifetime” appointments.

A proactive, results-oriented, board succession planning process is not as common as it should be. To accelerate real change at both the board and corporate level, a concerted enterprise transformation approach to diversity with measurable results must be initiated. Companies can and should do this by making concrete commitments and setting timelines for action.

Keeping Score

Over the past decade, study after study has highlighted the lack of gender and ethnic diversity on corporate boards and slow progress in the C-Suite. At the same time, shifting demographics, investor pressure, and a growing body of research has shown that diverse boards and executive teams are more effective and drive better business outcomes. There have been gender diversity quotas in Europe for the past 15 years. For years, governance and academic experts have doubted that quotas will take hold in the United States.

The state of California proved that keeping score works. In 2019, 126 California public companies

added 138 women to their previously all-male boards ahead of a December 31 deadline for a new law requiring companies headquartered in the state to have at least one female director. The state has also recently introduced legislation around racial and ethnic diversity.

Announced in January 2020, Goldman Sachs will not take companies public unless the company has at least one diverse board member, with a focus on women, as of July 2020.

Boards’ mandates on diversity and inclusion have expanded greatly in the wake of the protests over social injustice. In July 2020, Institutional Shareholder Services (ISS) called

on United States companies to disclose the ethnicities of their directors and senior executives. Campaigns to collect ethnicity data for executives and board members at all public companies are being launched by top investment funds. If words do not translate into

action, it is not unrealistic to expect legislation and quotas to follow. Additionally, in August 2020, the NYC Comptroller sent letters to a majority of S&P 100 companies, requesting their commitment to disclose the Consolidated EEO-1 Report.

The New Matrix

Most boards do not have a well-articulated succession plan. The scrutiny on board composition and diversity means boards must develop near-, mid-, and long-term succession plans and demonstrate action into results. Boards must also look to shift their talent-sourcing criteria, as the current, and somewhat archaic, standards have resulted in a small and homogenous pool of candidates that misses out on a broader and more diverse pool of talent. Experience as a chief executive officer or experience on a public company board has historically been a must-have credential. While there are merits to having a sitting or recently retired chief executive officer on a board of directors, this has contributed to a lack of diversity in the boardroom.

Boards must look beyond sitting and recently retired CEOs as the primary pool for director talent. Considering executives with experience in technology, human resources,

marketing, and risk management, among others, is an action that will have results for underrepresented groups.

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The current “talent matrix” tool is a widely-used, simple process to identify director skills and experience so gaps can be identified, and the director succession planning process can be managed. While investors are becoming more vocal with their expectations of boards to proactively drive a process that identifies gaps in skills and experience, and an approach to deal with those gaps, the actual matrix has not changed.

Although the climate companies operate in constantly evolves, the matrix remains constant, with active and retired CEOs, CFOs and financial executives, and governance experience prioritized. Skills and experience such as risk management, marketing, legal, and human resources have not shown great gains. Chief Customer and Marketing Officers bring experience in digital transformation, customer relationship management and loyalty, mobile platforms, and omnichannel strategy. This is, for example, very relevant experience for any consumer-facing company.

Today, boards are very focused on issues around talent, culture, and executive compensation. This was not the case two years ago. Boards are increasingly expected to be proactive in setting the tone at the top and shaping a corporate culture that does not tolerate bad behavior, including sexual harassment. As another example of a skillset that has not been prioritized, the Chief Human Resources Officer can help guide management on the potential impacts of COVID-19 on executive compensation across stock market volatility, incentive goals, pay reductions,

and motivating employees. Most boards do not have directors with human resources expertise and do not consider that experience as part of its board recruitment process.

BlackRock: “We encourage boards to disclose their views on the mix of competencies, experience, and other qualities required to effectively oversee and guide management in light of the stated long-term strategy of the company...”

Vanguard: “Based on your company’s strategy, what skills and experience are most critical for board members, now and in the future? How does the board plan for evolution and future director selection (that is, for strategic board evolution)?”

The “new talent matrix” will include skillsets previously dismissed. This is an action that can have an impact on diversity in the boardroom. If actioned, we will see more first-time directors bringing experience across human capital, legal, marketing and brand, e-commerce, and risk management.

What Boards Can Do

Leverage an ongoing board evaluation process:

- Review board structures and board processes for compliance of governance requirements.
- Agree upon how to prioritize committee work (high, medium, low).
- Agree upon key criteria, skills, and capabilities for lead director, committee chairs, and full board.
- Review contributions of individual directors, group dynamics, and committee effectiveness.
- Ensure lead director and committee chairs are chosen – and performing - in alignment with agreed upon key criteria and clear expectations for the work expected.

Ongoing succession planning:

- Rotate committee members (including the chair) after five years.
- Rotate committee members based on retirements of directors on the board.

Boards that proactively drive a board succession process will be in a stronger position. This kind of work requires strong leadership by the lead director, non-executive chair, and chair of nominating and governance. Done intentionally, this work will have positive implications on diversity in the boardroom.

Signs of Change on the Horizon

The outlook for long-term change in the corporate world is hopeful. Companies, business leaders, and many others have increasingly progressed towards meaningful action that champions genuine and profound change. One current example of this is the recent launch of The Board Diversity Action Alliance.

The Board Diversity Action Alliance (BDAA) is a new initiative with a mission to take action to increase the representation of racially and ethnically diverse directors on corporate boards of directors, beginning with Black directors. More specifically, the BDAA is leading a focused and aligned effort to quantify, convene, and amplify the work

being done to promote board diversity, by building partnerships with the corporate and non-profit community to increase awareness and expand influence. To best serve all stakeholders, companies need to understand their employees' communities and have a clear point of view.

Companies that join the alliance as “signatories” will accelerate change by committing to support a concerted enterprise transformation approach to diversity by integrating talent, accountability, and engagement. More specifically, signatories voluntarily commit to: increase the number of Black directors on its corporate board of directors to one or more; disclosure of the self-identified race and ethnicity of directors on corporate boards; and report on diversity, equity, and inclusion measures on an annual basis.

Teneo is pleased to be a founding member of the BDAA, along with founding partners Ursula Burns, Gabrielle Sulzberger, The Ford Foundation, the Boulé and The Executive Leadership Council.

Diversity of background, thought, and experience at the board and C-Suite level leads to better decision making. Yet, despite the years of focus on diversity, the pace of change has been glacial. If there is to be real change, the “call” to diversify the C-Suite and corporate boards must be more than simply a “call.”

If companies seek to achieve true and lasting change, their actions and work will matter more than words. And that work has to start with the board.