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Institutional Investors Lead Push for Gender-Diverse Boards

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Despite decades of companies' commitments to improve gender diversity at all levels of senior leadership, female representation on US corporate boards remains low: according to State Street Global Advisors (SSGA), one out of every four Russell 3000 companies do not have a single woman on their board and nearly 60% have fewer than 15%. Women held 18.8% of the board seats of companies in the Fortune 1000 in 2016. Frustrated by the slow pace of change, the world's largest institutional investors are now taking the campaign directly to their investees, arguing that gender diversity at the board level is material to a company's financial performance.

SSGA and BlackRock recently announced their renewed commitment to holding boards to account, each warning that they are prepared to vote against directors when boards fail to make progress in improving diversity. Boards with minimal female representation (defined by SSGA as fewer than 15% of directors) must therefore meaningfully address their diversity issues. This note will help boards better understand the imperative for gender diversity and the steps that should be taken in the near term to avoid being targeted by disgruntled institutional investors.

SSGA: Running Out of Patience?

Though gender diversity has been a thematic engagement area for SSGA since 2015, their March 2017 guidance note is the most explicit to date in making the link between female board representation and financial performance. Whereas advocacy campaigns elsewhere have often treated gender diversity as peripheral to broader performance analysis or viewed it as an end in itself, SSGA has placed the issue firmly within the mainstream by positioning gender diversity as a means to effective board leadership, which it views as *"foundational to good governance and positive investment outcomes."* The guidance note advises that SSGA will engage directly with companies to encourage the addition of more female directors and are prepared to vote against nominating committee chairs of boards that fail to do so.

Clients may be aware that SSGA previously focused its engagement efforts on the issue of average board tenure and in 2015 voted against or withheld votes for long-tenured board members at 380 companies. By 2016, an estimated 32% of companies targeted had added at least one new director.

BlackRock: Diverse Boards Make Better Decisions

BlackRock used its annual publication of engagement priorities in March 2017 to underscore the importance of diversity of all kinds, with a specific focus on improving gender balance in the boardroom. Like SSGA, BlackRock explicitly ties diversity to board effectiveness and performance, echoing the recent Commonsense Corporate Governance Principles (discussed on the Forum here) pronouncement that *"diverse boards make better decisions."* The world's largest asset manager will engage with companies in order to better understand their progress on improving gender diversity, but warns that that it will hold nominating and/or governance committees accountable if a company does not make progress on diversity initiatives *"within a reasonable time frame."*

Our Perspective on What Boards Should Do Next

Based on our discussions with leading investment management firms and pension funds, it is clear that concern for gender diversity at the board level is not unique to SSGA or BlackRock. Rather, it is now a recognized priority for most institutional investors, as evidenced by the Investor Stewardship Group's February 2017 Principles of Corporate Governance (discussed on the Forum here), which state that *"a well-composed board should also embody and encourage diversity, including diversity of thought and background."*

Boards that fail to meet SSGA's suggested 15% threshold should therefore expect increasing pressure from institutional investors to, in the near-term, communicate plans and targets for improving gender diversity to investors and, in the longer-term, demonstrate results. To this end, we believe clients should consider the following actions:

1. **Broaden the approach for evaluating director candidates:** Many companies cite a limited pool of suitable female director candidates as the primary obstacle to improving gender diversity. This is often the result of a narrow definition of criteria for the role that inherently disadvantages female candidates. For example, requiring that director nominees have public company P&L ownership experience above a certain size (e.g., $10B) immediately reduces the number of eligible women, without necessarily improving the quality of the pool. Broadening the criteria to include divisional CEOs with significant P&L responsibility (above $3B) widens the pool of eligible female candidates. Boards should screen for the types of skills and competencies required by the company's strategic context and be open to leaders in staff functions such as finance, marketing or operations to increase the talent pool of diverse candidates generally.
2. **Take a longer-term approach to board succession:** If each board search is treated as an individual event, there will be a tendency to develop criteria for the role that exclude potential candidates. If boards instead consider the next 2-3 vacancies that will occur over a few years, and develop a set of specifications to meet their emerging strategy, it is easier to ensure a pool of diverse candidates.
3. **Expand networks for sourcing director candidates:** In its guidance note, SSGA identifies "excessive *reliance on existing director networks and connections [as] the primary source for identifying director candidates"* as a key barrier to improving a board/s gender diversity. As such, boards should make every effort to source new directors via a diverse mix of channels rather than relying on existing networks.

4. **Communicate your plan to investors:** Investors understand that sourcing qualified directors takes time, but they also want to see evidence that boards are making this a priority and taking steps in the right direction. It is important that boards clearly communicate their plans and policies on gender diversity to investors. Details on the steps being taken and results achieved to date should be readily available, ideally in the proxy or on the company website.