Board Diversity Position Paper

September 2016

1 Executive Summary

The boards of Australian companies are predominantly made up of directors who share the same gender, are of similar age, and cultural and professional backgrounds. Despite increasing evidence of a correlation between forms of diversity (including gender) and company performance, Australian companies have so far been slow to increase the diversity of their boards and executive teams. This paper contends that this slowness to act means companies are failing to fully benefit from their existing and potential human capital and consequently constraining financial performance, which should be of concern for all investors.

While acknowledging structural constraints exist, we call on business leaders to accelerate their efforts and to focus on the strategic, concrete steps likely to have the greatest impact on diversity – and we specify these herein. The real challenge continues to be overcoming unexamined assumptions about what constitutes a good leader, particularly within a board. This will require a strong commitment to more rigorous consideration of this question in the director search and selection process and targeted actions to remove barriers to underrepresented groups, including women.

Regnan is concerned that the debate around diversity is often narrowly framed around observable markers of diversity, such as gender and culture. We believe that for companies to create long term value for investors, it is pursuing a broader sense of diversity (functional diversity) that will generate the best returns. Regnan would argue that if companies genuinely prioritise cognitive and experiential diversity, higher representation of women and culturally diverse individuals will emerge as a by-product. Likewise, if companies take a tokenistic approach, they will likely fail to gain the business benefits of diversity.

This paper is addressed primarily to company boards and highlights actions that they can take to improve diversity in their own ranks and throughout the organisations they direct. This focus recognises that in addition to the benefit to the board itself from the enhanced oversight capacity and functional ability that diversity brings, the board is positioned to drive change from the top and elevate diversity to be a strategic imperative for a company. We recognise that to maximise the positive impacts diversity can achieve, it needs to be present among all of those who drive company value, not just at the top.

1.1 Call to action for boards

Regnan represents institutions who invest for the long term and fiduciary duty requires them to rigorously scrutinise the performance of the companies in their portfolios. These investors therefore have an interest in ensuring the companies in which they invest engage appropriately with the challenges and the opportunities presented by increased diversity. While acknowledging that some barriers to diversity are external to the business world, there are concrete actions that companies can take to increase diversity which will support the creation of long term value.

Specifically, Regnan expects S&P/ASX200 companies to evidence efforts to improve board and executive diversity within the context of the company's particular business needs by:

- Explaining when and how diversity is aligned with business strategy, for instance through a diversity policy. It could also include setting and publicly reporting progress in achieving any diversity objectives.
- Designing recruitment and promotion processes for board or executive candidates to account for unconscious bias and known barriers to diversity. The process should challenge unexamined/unwarranted assumptions about the skills and qualities required for management and leadership positions.
- Adopting a more transparent approach to the chosen selection process, especially through disclosure of the rationale for appointing a particular candidate. For a director appointment, for instance, this could entail clearly articulating the skills and competencies required by the board in the context of the company's business strategy, market position and the wider socio-political environment, and discussing how a particular appointment fits within this strategy. Regnan particularly encourages the identification of key business risk areas that may benefit from improved oversight if board skills in that field were strengthened.
- Developing and disclosing strategies for sourcing those skills and competencies within populations not already well represented among current directors – focusing not only on gender but also other aspects of diversity (e.g. age, cultural and professional background) – which might add value on a given board. Regnan supports enhanced consideration of professions not traditionally seen to add value to a board, especially given that rapid societal and technological changes have increased the need for greater occupational segregation to provide adequate oversight of strategy and business risk.
- Considering whether the board could introduce measures to create opportunities for a diverse candidate to be appointed. Reducing the maximum length of tenure or creating an additional position, if appropriate, could enable increased diversity without negative effect on board performance.
- Assigning clear responsibility for the company's diversity objectives, at board and at executive management level. An authentic and visible commitment from the CEO and leadership team is essential to advance a broader diversity agenda. Having the CEO take a

leadership role in advancing the diversity agenda throughout the company, such as by leading a dedicated taskforce, could provide the adequate focus required to improve diversity in a timely manner. Explicit acknowledgement by the CEO of barriers to diversity, such as unconscious bias, could prompt recognition within the rest of the company of such dynamics if and when they occur.

- Taking steps to identify and address informal barriers to meritocratic progression, for instance by investigating reasons for failure to recognise, recruit, retain, cultivate or promote women and other underrepresented groups in numbers roughly proportionate to their presence within the population. Supporting initiatives to transform the workplace so it is more flexible and inclusive will increase a company's ability to retain talent, while mentoring, education and networking can aid in individuals' leadership development and acquisition of skills needed at board and executive level.

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3 Board diversity is about more than gender

In recent years there has been increasing awareness in Australia and other countries of the lack of diversity on company boards. That much of the attention has focused on gender diversity is unsurprising when considering the lack of progress despite sustained high rates of female participation in the workforce. Only 23.6% of directors on S&P/ASX200 boards are female and 20 companies have an all-male board.[1] Female representation is even lower among key management personnel (20.2%).[2] Yet women have comprised at least 40% of the Australian workforce for more than a generation,[3] with significantly increased participation over the last several decades[4] adding more talent to the already substantial pool. Further, in every cohort, including those age groups most represented on boards, women are as likely as their male counterparts to have attained qualifications of a Bachelors' degree or above.[5] In defiance of these long established workforce changes, male leaders and many others still express complacency that 'time will take care of it'.

While the lack of women at the top of Australian organisations needs to be addressed, it should also be understood as symptomatic of a broader lack of diversity. For this reason, it will take more than simply increasing women's numbers to deliver diversity's business benefits. Boards need directors of different ages, capabilities, experiences and outlooks. New appointments will not necessarily add value if they otherwise resemble the incumbents.

To date, Australian boards have mostly appointed former executives as directors – a factor often attributed to the need for extensive corporate experience. However, favouring such experience has not translated into breadth of professional experience and skills among directors. A total of 46.8% of directors come from financial services, accounting or legal backgrounds.[6] Despite the significance of the services sector, and of human capital management in generating value within it, directors with human resources and deep change management experience represent only 0.5% of directors in the ASX100.[7] Diverse experience among members of a board supports effective oversight of strategy and business risk.

Overemphasis placed on a particular type of experience can result in a talented candidate's capabilities and characteristics being overlooked. For example, candidates with experience in fields outside of business, or candidates with diverse outlooks informed by different economic or social conditions, are likely to further the cognitive diversity of a board. Further, the pursuit of candidates with extensive corporate experience commonly results in the director pool being filled with those in a similar late stage in their careers.[8] This also unsurprisingly corresponds to a limited age range among directors. A strong understanding of the core business is certainly necessary on a board, but

[1] Australian Institute of Company Directors, May 2016, http://www.companydirectors.com.au/director-resource-centre/governance-and-director-issues/board-diversity/statistics
[2] Workplace Gender Equality Agency, 2016, 'Gender equality in ASX 200 organisations'
[3] Since 1989. Australian Bureau of Statistics, 2016, 'Labour Force, Australia, June 2016'
[4] Male workforce participation has declined from 79.3% in 1978 to 70.4% in 2016, while women's participation has increased from 43.4% to 59.3% over the same period. Source: Australian Bureau of Statistics, 2016, 'Labour Force, Australia, June 2016'
[5] Australian Bureau of Statistics 2015, 6227.0 - Education and Work, Australia, May 2015
[6] 38.4% of directors are from financial services and accounting backgrounds, and 8.4% are from a legal background. Watermark Search International, 2016, '2016 Watermark Board Diversity Index'
[7] Ibid
[8] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?'

late-career corporate backgrounds, especially if it may have been years since their last executive role, are unlikely to be sufficient in a business environment characterised by disruption, accelerating change in operating conditions and increased reliance on (rapidly evolving) technology. Having a board comprised of directors with a greater range of ages and career stages is likely to promote diversity of thought and enhance the board's collective skillset relevant to responding to changes in the operating environment. Refreshment should be active and ongoing.

It is questionable that the business benefits of diversity will be achieved without wider representation of divergent socio-demographics on boards. Currently, a majority of Australian boards are comprised of directors from similar socio-demographic backgrounds, and some even come from the same social networks.[9] While some boards have made improvements on the more observable aspects of diversity, such as gender and ethnic diversity, these aspects may conceal that an individual otherwise thinks and acts like incumbent directors, resulting in the perpetuation of board homogeny.

Regnan believes the lack of diversity in this broader sense among the boards and senior management of Australian companies represents a lost opportunity for companies and for shareholders.

4 Board diversity – opportunities lost

The case of gender is a particularly visible example of the lack of board diversity given that statistical information about male and female population characteristics, workforce participation and leadership positions is readily available. In spite of ASX 'Corporate Governance Principles and Recommendations' disclosure requirements introduced in 2010, and recent initiatives such as Male Champions of Change and the 30% Club, progress continues to be slow. Even with women comprising 34% of new appointments to S&P/ASX200 boards in 2015,[10] it is unlikely that Australia's top 200 companies will reach 30% female directors by 2018; the target supported by the AICD and the 30% Club. The number of women chairing S&P/ASX200 companies also remains low, currently a total of eight.[11]

The figures are equally underwhelming in the case of women at senior management levels. Despite gender parity existing across S&P/ASX200 companies in non-managerial roles, only 35.3% of managers are women.[12] The gap increases with seniority, with women accounting for just 20.2% of key management personnel[13] and this number being disproportionately comprised of female human resources executives and company secretaries.[14] Only 8.7% (or approximately 17) of S&P/ASX200

[9] Tyson, L., 2003, 'The Tyson Report on the Recruitment and Development of Non-Executive Directors, London School of Economics, June; The Age, 2009, 'Old boys' network rules the boardroom', 13 August; Government, Corporations and Markets Advisory Committee, 2009, 'Diversity on Boards of Directors', March
[10] Australian Institute of Company Directors, May 2016, http://www.companydirectors.com.au/director-resource-centre/governance-and-director-issues/board-diversity/statistics
[11] Source: S&P/ASX200, as at August 2016
[12] Workplace Gender Equality Agency, 2016, 'Gender equality in ASX 200 organisations'
[13] Ibid
[14] ASX and KPMG, 2016, 'ASX Corporate Governance Council Principles and Recommendations on Diversity: analysis of disclosures for financial years ended between 1 January 2015 and 31 December 2015'

CEOs are women, and the figures are also low for female representation among CFOs and COOs.[15] If women are underrepresented in these senior positions this is likely to flow through to female representation on company boards given director appointments overwhelmingly favour executive experience.

Several global studies have linked the prevalence of female board directors with company outperformance. This includes research by Catalyst,[16] Credit Suisse[17] and Grant Thornton.[18] Variously, researchers have detailed evidence of higher profits, valuation and stock price, among other financial performance metrics, relative to those of companies with low female board representation. An even more substantial finding is positive correlation between gender diversity among executive (as opposed to director) ranks and stronger financial performance.[19] A recent Peterson Institute for International Economics study highlights the financial impact of even statistically small improvements. For example, it finds a firm with gender diverse leadership can expect to add more than one percentage point to its net margin compared with an otherwise similar firm without female leaders. Given that a typical profitable firm in their sample had a net profit margin of 6.4 percent, a one percentage point increase represents a 15 percent boost to profitability.[20] However, the reasons for this outperformance are not entirely clear and few studies have set out to test causality.[21]

Regnan believes that it is the impact of diversity on consideration of social and governance factors that most strongly illustrates its business case. A broader professional skillset on the board improves its ability to anticipate, understand and manage a wider variety of risks and opportunities in an evolving and complex environment, and review strategy and monitor management accordingly. Establishing a board of directors with diverse experiences, abilities, professional backgrounds and outlooks can also result in better board functionality and effectiveness and, thus, can be a powerful antidote to groupthink and bias.[22] Diversity of thought has been well-established as beneficial for problem solving, innovation and creativity. In particular, diverse boards benefit from increased experimentation, knowledge transfer, capacity to work across functional or business boundaries and general efficiency.[23]

[15] Workplace Gender Equality Agency, 2016, 'Gender equality in ASX 200 organisations'
[16] Catalyst, 2007, 'The Bottom Line: Corporate Performance and Women's Representation on Boards'
[17] Credit Suisse Research Institute, September 2014, 'The CS Gender 3000: Women in Senior Management'
[18] Grant Thornton, 2015, 'Women in business: The value of diversity'
[19] Peterson Institute for International Economics, 2016, 'Is Gender Diversity Profitable? Evidence from a Global Survey'; Credit Suisse Research Institute, September 2014, 'The CS Gender 3000: Women in Senior Management'; International Monetary Fund, 2016, 'Gender Diversity in Senior Positions and Firm Performance: Evidence from Europe'; McKinsey, 2015, 'Why diversity matters'
[20] Peterson Institute for International Economics, 2016, 'Is Gender Diversity Profitable? Evidence from a Global Survey'
[21] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', Delaware Journal of Corporate Law, vol.39; Gupta, Parveen P.; Lam, Kevin C. K.; Sami, Heibatollah and Zhou, Haiyan, 2015, 'Board Diversity and Its Long-Term Effect on Firm Financial and Non-Financial Performance'
[22] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', Delaware Journal of Corporate Law, vol.39
[23] McKinsey & Company, 2007, 'Women Matter: Gender Diversity, a Corporate Performance Driver'

5 Why has progress on diversity been so slow?

Like other OECD countries, Australia has been slow to improve the representation of diverse groups in board and senior management positions.[24] This occurs for a number of reasons; unconscious biases, structural impediments and poorly targeted interventions.

Unconscious biases

Studies show that homogenous boards – like other groups – exhibit 'in-group' bias; a tendency to prefer individuals with characteristics that resemble themselves.[25] This results in replenishment of the director pool in a manner that maintains homogeneity through time, as boards themselves control director nomination and selection. In extreme cases, social networks dominate director appointments,[26] but emphasis on collegiality can produce the same result.

In-group biases also perpetuate prejudices about what constitutes competence and leadership, affecting executive appointments. Applicants are often overlooked due to a lack of the leadership characteristics with which incumbents identify, without consideration of whether these characteristics are really priorities for the role. Indeed, a large body of academic work details evidence that people more readily consider (Anglo) men to have leadership ability and more readily recognise men as leaders.[27] This artificially limits the talent pool for executive ranks, restricting the breadth and quality of the skillsets applied to the diverse challenges inherent in running Australian companies, as well as producing artificial constraints on the 'pipeline' for director appointments.

Many studies find that women and underrepresented groups are held back in the workplace by unconscious bias.[28] Others find that male achievements are more likely to be attributed by workplace peers to individual capabilities such as intelligence, drive, and commitment, while female achievements are often attributed to external factors such as luck or special treatment.[29]

Intersecting biases make it very difficult for women to overcome these assumptions about leadership. Women are judged unfavourably both on the basis of gender stereotypes (such as women being insufficiently tough negotiators or insufficiently aggressive in business[30]) as well as for overcoming them.[31] For instance, if women don't demonstrate traits perceived to be feminine – such

[24] Workplace Gender Equality Agency, 2016, 'International gender equality statistics'
[25] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', *Delaware Journal of Corporate Law*, vol.39
[26] Tyson, L., 2003, found that almost half of the directors interviewed to have been recruited through personal friendships and connections 'The Tyson Report on the Recruitment and Development of Non-Executive Directors, *London School of Economics,* June
[27] Credit Suisse Research Institute, September 2014, 'The CS Gender 3000: Women in Senior Management'
[28] McKinsey & Company, 2011, 'Changing companies' minds about women', *McKinsey Quarterly*, September
[29] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', *Delaware Journal of Corporate Law*, vol.39
[30] Ibid
[31] Sandberg, Sheryl, 2013, 'Why I want women to lean in', *Time*, March 7, [Available: http://ideas.time.com/2013/03/07/why-i-want-women-to-lean-in/]

as being helpful or nurturing – they can be deemed difficult, selfish or 'not a team player'.[32] Men, however, face no penalty for being less altruistic.[33]

Structural impediments

Further away from the boardroom and C-suite, we find that numerous social and workplace barriers mask the talents, impede the contributions, and limit recognition of many individuals, including on the basis of their gender and cultural characteristics. One such barrier is associated with the role of many women as primary carers within families, which limits participation in the 'anytime, anywhere' culture that has become part of contemporary corporate expectations.[34]

In reality, not all senior roles routinely require unflagging availability, regardless of time or place.[35] Quality of input can and should be prioritised over hours served.

Similarly, there is often an expectation that the path to leadership positions should be linear, uninterrupted by career breaks or periods of deliberately scaled-back employment taken by such women (and many men). Yet there is a lack of evidence that those who can demonstrate single-minded ambition throughout an executive career are always those best placed to lead twenty-first century workforces. In fact we find many instances of businesses being harmed when individuals at the helm are indisposed to taking broader interests or applying a more nuanced perspective.

Structural impediments are often pointed to as proof that gender diversity is an intractable problem beyond the role of business leaders to influence – especially by those seeking to justify their own lack of action. Such barriers do exist, but the conclusion that 'therefore nothing can be done' is flawed. In our view, such barriers are in fact a key reason why it is not sufficient to rely passively on the organic emergence of a 'pipeline' of women and others who can be recruited to boards, as is customary, from the ranks of senior executives.

Poorly targeted interventions

Half-measures towards diversity can also prove counterproductive.

Some companies have found their initial appointment of a director – that is, a 'token' appointment – from an underrepresented group to the board to be underwhelming.[36] This is not surprising given research that shows that such directors can face isolation as well as pressure to conform.[37] Studies suggest a critical mass of 30% is needed to overcome minority voices being pigeonholed as representing the outsider view.[38] These factors impair the contribution of diverse members, make

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32 Heilman, Madeline E., Chen, Julie J., 2005, 'Same Behavior, Different Consequences: Reactions to Men's and Women's Altruistic Citizenship Behavior', Journal of Applied Psychology, Vol 90(3), May

33 Ibid

34 McKinsey & Company, 2010, 'Women Matter 2010, Women at the Top of Corporations: Making it Happen'

35 McKinsey & Company, 2007, 'Women Matter: Gender Diversity, a Corporate Performance Driver'

36 Credit Suisse Research Institute, September 2014, 'The CS Gender 3000: Women in Senior Management'

37 Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', *Delaware Journal of Corporate Law*, vol.39

38 Kramer, Vicki W. et al, 2006, 'Critical Mass on Corporate Boards: Why Three or More Women Enhance Governance', *Wellesley Centers for Women Research & Action Report*, Fall/Winter. It is this concept that the 30% Club (gender diversity initiative) references in its name. http://30percentclub.org/

boards wary of further 'outsider' appointments, and limit the likelihood of reaching the critical mass that is required.[39]

Affirmative action and quotas (whether formal or unofficial) are another double-edged sword. Although they overcome the critical mass problem described above and create a needed catalyst for action, they may generate a backlash due to their perceived disjunction with prioritising 'merit'. This objection is a weak one. While 'merit' is inarguable, what is traditionally judged to be 'merit' is at best unsubstantiated (many conventional 'merit based' appointments having in fact proved disastrous) and at worst circular, emphasising qualities apparent among incumbents.[40] Affirmative actions will only succeed in the long run when accompanied by recognition of the value to organisations that broader skills, experience, outlooks and professional qualities bring.[41]

6 Addressing barriers to diversity

With increasing acknowledgement of the barriers to diversity has come the development of responses and efforts to rectify the lack of underrepresented groups in the boardroom and C-suite. While many strategies more specifically target women, most initiatives can also be applied to other types of diversity. This section reviews the options and provides background to the priorities set out in the call to action above.

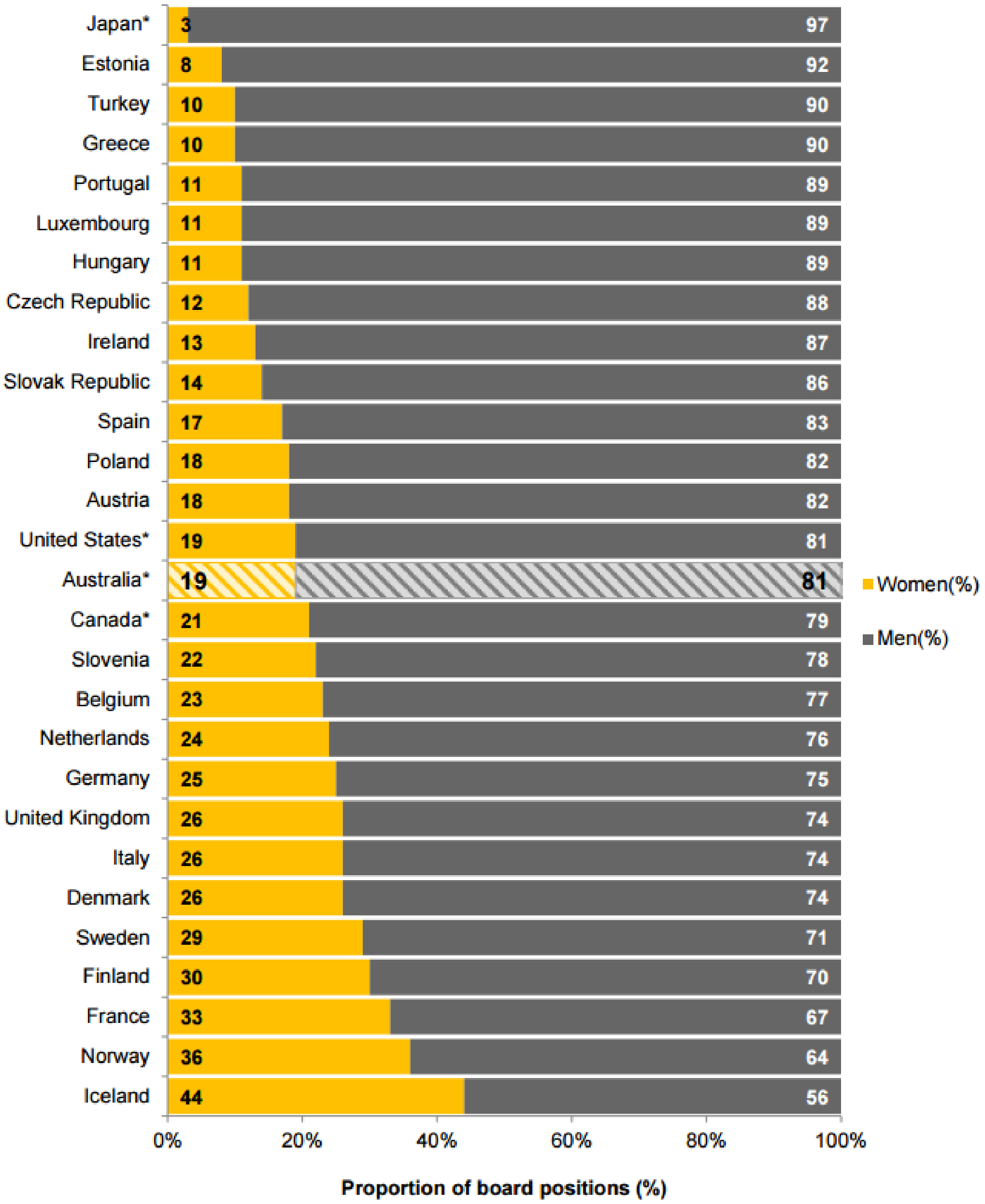
Regulatory action

Regulatory measures can improve diversity on boards as the introduction of quotas and targets for female board representation in several jurisdictions has shown. Norway led the way with a mandatory gender quota law, in effect since 2008, that penalises companies with delisting if they do not achieve 40% female representation.[42] Since then, gender quotas for boards have been imposed in Belgium, Iceland, Italy, the Netherlands and Spain (though with less severe sanctions and a 'comply or explain' requirement).[43] In 2015 Germany became the largest nation to introduce a gender quota.[44] Other countries such as the UK, have favoured voluntary targets with some success in boosting female participation.[45] While quotas face a variety of criticisms, Figure 1 shows that the proportions of women on boards in countries with quotas or hard targets are comparatively higher than countries that have opted for voluntary measures.

[39] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', Delaware Journal of Corporate Law, vol.39
[40] Ibid
[41] Castilla, Emilio J., 2016, 'Achieving meritocracy in the workplace', *MIT Sloan Management Review*, Summer
[42] Seierstad, Cathrine; Huse, Morten and Seres, Silvija, 2015, *The Conversation*, 'Lessons from Norway in getting women onto corporate boards', March 7
[43] The Economist, 2014, 'The spread of gender quotas for company boards', March 25
[44] New York Times, 2015, 'Germany sets gender quota in boardrooms', March 6
[45] Katz David A., and McIntosh, Laura A., 2016, 'Gender Diversity on Boards: The Future Is Almost Here', [Available: https://corpgov.law.harvard.edu/2016/03/25/gender-diversity-on-boards-the-future-is-almost-here/]

Figure 1.

Gender composition of boards on the largest# publicly listed companies (available data)



#number not specified *denotes 2014 data, all other data is from 2015.
Source: Workplace Gender Equality Agency.[46]

However, there is mixed evidence on whether companies operating in jurisdictions with gender quotas such as Norway have been as effective at improving financial performance as companies that are voluntarily diverse.[47] Some have suggested that the lower than expected performance of

[46] Workplace Gender Equality Agency, 2016, 'International gender equality statistics'
[47] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', *Delaware Journal of Corporate Law*, vol.39

Norwegian companies, for example, could be explained by the dual phenomena of inexperienced women being hurriedly appointed to meet the quota and many overcommitted women holding multiple directorships.[48]

Requiring reporting on diversity metrics and 'comply or explain' approaches are another means to improve transparency and accountability, further driving action. Disclosing data around metrics such as recruitment, staff retention and the makeup of senior management, allows stakeholders to hold companies to account, as well as forcing companies themselves to monitor progress.[49] At board and senior management level, disclosure around selection criteria for director appointments can advance diversity by not only demonstrating a company's commitment, but by explaining how diversity is aligned with business strategy.[50] Further, research indicates that the act of providing a reason for a particular course of action improves an individual's decision making and makes them less likely to rely on stereotypes, leaving the door open for more consideration of alternative ideas and groups.[51]

While legislation regarding quotas has not been introduced in Australia, influential bodies such as the AICD and the Australian Securities Exchange (ASX) have sent messages to companies that they expect action on gender diversity. Since 2011, the ASX Corporate Governance Council (ASXCGC) 'Corporate Governance Principles and Recommendations' has taken an 'if not why not' approach. ASX-listed companies are required to establish measurable diversity objectives and report on progress in achieving these, or to explain why they have elected not to do so.[52] The AICD has been a vocal supporter of a 30% target for female participation on ASX-listed boards. [53] This attention to diversity has resulted in many companies taking action in establishing diversity policies, including flexible working arrangements, and setting objectives in this area in the last few years. However, the S&P/ASX200 is still regarded as lagging behind the wider Australian community and other similar OECD nations when it comes to diversity (see Figure 1 above). That the rate of progress is out of step with community expectations, especially in relation to gender diversity, creates vulnerability to politically motivated regulation.

Regnan favours a 'comply or explain' approach and, in particular, suggests a rationale be provided for senior appointments not only to provide transparency for shareholders but to reduce barriers to diversity. Regnan does not advocate for quotas, believing that a more considered and imaginative approach to securing director and executive talent, combined with specific, targeted, evidence-based interventions, is likely to bring about the full benefits of improved diversity including improved performance. Gender quotas cannot guarantee the cognitive or functional diversity Regnan believes most significant in long term value creation. However, in the event of persistent

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[48] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', Delaware Journal of Corporate Law, vol.39

[49] ASX and KPMG, 2016, 'ASX Corporate Governance Council Principles and Recommendations on Diversity: analysis of disclosures for financial years ended between 1 January 2015 and 31 December 2015'

[50] National Association of Company Directors Blue Ribbon Commission, 2012, 'The Diverse Board: Moving from interest to action'

[51] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', *Delaware Journal of Corporate Law*, vol.39

[52] ASX, 2014, 'ASX Corporate Governance Council Principles and Recommendations (3rd Edition)'

[53] Australian Institute of Company Directors, 2015, 'Boards should adopt 30 per cent target for female directors', April 9

absence of progress, Regnan recognises that quotas may be required to break the cycle of self-reinforcing prejudices or, as mentioned above, be introduced for political reasons.

Investor-led initiatives

As institutional investor focus on environmental, social and governance (ESG) related sources of risk and opportunity has rapidly increased, so too has focus on diversity. In recent years, investors have been leveraging their position as significant shareholders to directly lobby for increased action on diversity during dialogue and by supporting pro-diversity initiatives such as the 30% Club.[54]

Engagement by investors on the topic of diversity has become increasingly popular, going hand in hand with the rise of active ownership. Regnan has conducted engagements on behalf of its institutional investor clients seeking improvements in cognitive diversity among the boards of stocks that are facing new business risks or opportunities that are likely to benefit from diverse perspectives.

To hasten progress on diversity, some large investors have also been explicit in their strategies to reward or reform companies according to their diversity performance, and others have been active in impact investment strategies that advance diversity.[55] For example, the pension fund CalSTRS reportedly invested US$250 million in State Street Global Advisors' SPDR SSGA Gender Diversity Index ETF, an exchange-traded fund that invests in US companies with the highest levels of gender diversity in their sectors.[56] Institutional investors are undoubtedly in a strong position to put pressure on companies to not only reduce barriers to diversity but to also actively pursue the performance related benefits to increase long term shareholder value.

Developing future candidates

A common justification of underrepresentation of minorities on boards is a lack of suitably qualified candidates. While this belies an existence of competent prospective directors who are often overlooked for aforementioned reasons such as unconscious bias, myths around merit and the existence of structural impediments, more can be done to ensure that there is a larger pool of capable, experienced and confident directors and executives from diverse backgrounds. Mentoring, education and networking programs can aid in individuals' leadership development and acquisition of skills and knowledge to ensure they are 'board ready'.[57] Some initiatives in Australia that seek to support prospective women directors and senior executives include Chief Executive Women's development programs[58] and the AICD's diversity scholarships.[59]

[54] Katz David A., and McIntosh, Laura A., 2016, 'Gender Diversity on Boards: The Future Is Almost Here', [Available: https://corpgov.law.harvard.edu/2016/03/25/gender-diversity-on-boards-the-future-is-almost-here/]
[55] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', *Delaware Journal of Corporate Law*, vol.39
[56] Katz David A., and McIntosh, Laura A., 2016, 'Gender Diversity on Boards: The Future Is Almost Here', [Available: https://corpgov.law.harvard.edu/2016/03/25/gender-diversity-on-boards-the-future-is-almost-here/
[57] National Association of Company Directors Blue Ribbon Commission, 2012, 'The Diverse Board: Moving from interest to action'
[58] Chief Executive Women, http://www.cew.org.au/what-is-the-leaders-program
[59] Australian Institute of Company Directors, http://www.companydirectors.com.au/director-resource-centre/governance-and-director-issues/board-diversity/diversity-scholarship-program

Changing the selection process

Processes for the nomination and selection of candidates for executive and board roles can be structured to account for the known barriers to diversity. Below are some examples of measures that can allow for a broader range of candidates to be put forward, or can reduce the impact of potential biases of decision makers:

- Provide training and education for members of relevant decision making committees to improve their cognisance of unconscious bias and recognition of unconventional talent and leadership. It is worth noting that Harvard Business Review recently published a piece suggesting opt-in (or 'carrot' measures) rather than compulsory training ('stick') is far more effective in addressing biases.[60] Behavioural science studies show that people often respond to compulsory courses with anger and resistance, sometimes even with heightened animosity towards other groups upon completion.[61]
- Set selection criteria that includes a broader range of skills, professional backgrounds and experience. For instance, committees may consider competent candidates from the not-for-profit sector, management consulting or academia in addition to applicants with C-suite experience.
- Set a minimum number of applicants from an underrepresented group that must be put forward to the selection committee. To boost female applicants, for example, a company could opt for a 40% male, 40% female, 20% mixed gender ratio.
- Utilise 'blind' recruitment practices, which can include removing from resumes names or other features that may signal a candidate's gender or cultural background, or not conducting first round interviews face-to-face, to reduce potential bias.[62]

Regardless of specific recruitment processes chosen, greater transparency around these practices and decision making processes will further advance diversity. Disclosing any formal policies or initiatives will signal to stakeholders that the company is committed to improving diversity. Sharing the rationale behind a given appointment can be important to highlight the capabilities of the candidate and how the appointment is aligned with company strategy. A lack of transparency in this area may fuel criticism that merit is not the primary criteria considered in recruitment, an outcome which is counterproductive and risks entrenching the negative stereotypes such appointees face, as discussed earlier.

Transforming the workplace

Companies can take direct action to improve diversity and inclusion throughout the workplace. What is needed is a more systematic investigation by corporations into what formal and informal barriers prevent meritorious but unconventional talent from being retained, recognised, cultivated

[60] Dobbin, Frank and Kalev, Alexandra, 2016, 'Why diversity programs fail', *Harvard Business Review*, July-August issue
[61] Ibid
[62] For an example of blind recruitment, see: Rice, Curtis, 2013, 'How blind auditions help orchestras to eliminate gender bias', The Guardian, October 14, [Available: https://www.theguardian.com/women-in-leadership/2013/oct/14/blind-auditions-orchestras-gender-bias]

and progressed. An authentic and visible commitment from the CEO and leadership team is essential to advance a broader diversity agenda. This can be particularly powerful coming from male leaders as evidenced by the Male Champions of Change initiative. Indeed, a CEO-led dedicated diversity taskforce is considered by Harvard academics that have undertaken research on the matter to be the singular most impactful measure to improve diversity a company can take.[63] Such taskforces, they argue, can simultaneously introduce accountability, engage management and staff on the issue, encourage reviews of recruitment and promotion practices, and increase contact between diverse groups which can help break down biases.[64]

While mentoring and staff development targeted at supporting underrepresented groups can cultivate talent and broaden notions of leadership, changes to everyday working arrangements can attract diverse staff and improve retention. As discussed earlier, the burden of domestic duties and pressure to maintain the traditional role of primary carer can be a barrier to female career progression. Flexible working arrangements and initiatives that encourage women to return to work after maternity leave can greatly support gender diversity. Benefits that women gain from flexible working arrangements are amplified when men also participate. It breaks down the stigma still often associated with 'flex work', allows for men to share in a greater portion of domestic and caregiving duties,[65] and normalises achieving a work/life balance without harming career progression.[66] To encourage greater uptake by all staff, but especially men, it is important for senior management to become advocates for, and participate in, flexible work. Companies should actively work to enable part-time hours at senior levels. Research has shown inclusive, flexible and diverse workplaces to be more innovative[67] and have higher employee engagement and retention.[68]

Opening up board seats

The prevailing trend of the low turnover of board positions is slowing the rate of progress on diversity. Often directors, enjoying a generous salary and professional prestige, are reluctant to retire from a board.[69] To counter this phenomenon, some have suggested that the answer lies in restricting the age limit of directors and/or setting a maximum length of tenure.[70] Regnan notes a shift toward shorter terms could have the added benefits of bringing fresh thinking and a willingness to re-examine the merits of past decisions, not just provide opportunities for increased diversity. Another possibility is to increase the number of board positions if and where appropriate. It may be the case that some Australian boards have capacity to add a seat (the average board sizes of ASX100 and ASX101-200 companies are 8.5 and 6.6 members respectively[71]) with a neutral to positive effect on performance.

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[63] Dobbin, Frank and Kalev, Alexandra, 2016, 'Why diversity programs fail', Harvard Business Review, July-August issue
[64] Ibid.
[65] Slaughter, Anne Marie, 2016, 'It's Time to Make 'Women's Work' Everyone's Work', *The Atlantic*, August 3 [Available: http://www.theatlantic.com/video/index/494165/anne-marie-slaughter-interview/]
[66] Bain & Co and Chief Executive Women, 2016, 'The power of flexibility: A key enabler to boost gender parity and engagement'
[67] Chen, Jie; Leung, Woon Sau and Evans, Kevin P., 2015, 'Board Gender Diversity, Innovation and Firm Performance'
[68] Bain & Co and Chief Executive Women, 2016, 'The power of flexibility: A key enabler to boost gender parity and engagement'
[69] National Association of Company Directors Blue Ribbon Commission, 2012, 'The Diverse Board: Moving from interest to action'
[70] Rhode, Deborah L. and Packel, Amanda K., 2014, 'Diversity on corporate boards: How much difference does difference make?', *Delaware Journal of Corporate Law*, vol.39
[71] ACSI, 2015, 'Board Composition and Non-Executive Director Pay in ASX200 Companies: 2014', October

Widening the debate on diversity

To improve genuine diversity throughout corporate Australia, debate needs to move beyond the observable markers of diversity, such as gender and cultural diversity. This is especially needed when discussing the value proposition of diversity; it is functional and experiential diversity that will generate the best returns for investors. While women and culturally diverse individuals may be likely to further functional and experiential diversity, attributing the value they may bring to a company to such characteristics fails to acknowledge cognitive diversity as the real driver of long term value. Further, to maximise the positive impacts diversity can achieve, it needs to exist at all levels of a business, not just at the top. Installing non-traditional candidates on a board is unlikely to have a 'magic wand' effect on company performance if it is not also present among all of those who drive company value.