

Getting Back on the Diversity

The number of women and minority directors is barely growing. Here's why that's worrisome, along with some expert ideas for finding good new candidates.

Does your board look like a cross section of America? To what extent should it? Nearly everyone talks up the value of diversity and the perspective it brings to the board table—and the pressure to name more women and minority directors has been building. Yet the pace of gains has slowed significantly at large corporations and all but halted at smaller ones.

This is noticeable at a time when the country itself is growing more diverse and companies operate in a global economy. Directors have only to gaze across the pond at Norway, which this year completed a stunning transformation that put women into 40% of the board seats at publicly traded companies. In the U.S., however, “we’re not seeing the increase in diversity that a lot of people had been predicting,” says Carol Bowie, head of the Governance Institute at RiskMetrics Group’s Rockville, Maryland, unit, which tracks boardroom developments. “The only trend that we can identify is stagnation.”

In fact, the percentage of women on big-company boards jumped by more than a third in the past decade, but the pace has slowed in the last few years. Women last year held 15% of the seats on the boards of companies in the Standard & Poor’s 500-stock index, according to RiskMetrics. That’s 15% more than the 13% of seats they held in 2002 and 36% more than their 11% share of seats in 1997. By comparison, however, U.S. Equal Employment Opportunity Commission statistics show that women make up nearly 48% of the U.S. workforce. And African Americans, Hispanics, and Asians—men and women together—held 11% of S&P 500 board seats in 2007, the same as in 2002, and they total about a third of the workforce.

Failure to diversify can lead to missed

“Let’s say you’re in the music business. If all you know is Sinatra, you will fail to see the arrival of hip-hop. You will lack perspective.”

Herman Bulls
Director, Comfort Systems USA



opportunities. "Let's say you're in a boardroom in the music business," says Herman Bulls, 52, an African American who sits on the board of Comfort Systems USA Inc., a Fortune 1,000 provider of commercial heating and ventilation systems. He's president of Bulls Capital Partners, a Fannie Mae multifamily-housing lender in Vienna, Virginia, and CEO of the public-institutions group at real estate services firm Jones Lang LaSalle. "If all you know is Sinatra and Tommy Dorsey, you will fail to see the arrival of hip-hop. You will lack perspective and understanding of what's happening in the market."

Signs are growing that women and minorities bring fresh perspectives to boardroom decisions that can flow straight to the bottom line (see the box at right). Last March researchers at Oklahoma State University and Loyola College in Maryland reported that a study of Fortune 500 companies from 1998 to 2002 showed a positive link between the presence of women and minority directors on boards and increased corporate value. Another study by Catalyst, a coalition of women's groups, found that Fortune 500 companies with the most women directors had better returns on equity, sales, and invested capital than companies with the fewest such directors.

The boards of companies tied to consumer markets tend to be the most varied. Of the 12 outfits the study cited as having more than 40% boardroom diversity, eight were in the retail, consumer-products, or financial field. Among them: Albertson's, PepsiCo, and Aetna.

The problem at many companies is that "boards tend to be looking for CEOs and people at that level," says Julie Daum, who heads the North American board-services practice for the Spencer Stuart search firm. But there's still not much diversity in those top executive suites, she notes. At the same time, as Sarbanes-Oxley regulations make board service more demanding than ever, companies want their directors to serve on fewer boards. So the small pool of female and minority

industry leaders being sought as directors can't provide enough people to fill all the slots. William F. Murdy, 66, chairman and CEO of Comfort Systems USA, says two women whom he wanted to nominate for a board seat this year turned him down because they were too busy. According to Spencer Stuart,

HOW DIVERSITY EQUALS DOLLARS

Diversity boosts the bottom line and shareholder value. That's the conclusion of two major studies of all Fortune 500 companies. The women's group Catalyst in 2007 found sharply higher profitability for companies with the largest percentage of female directors as compared with companies with the lowest percentage. A 2008 report from researchers in the finance departments of Oklahoma State University and Loyola College in Maryland found that companies with ethnic and gender boardroom diversity did better in the stock market than those without it. The findings:

- Results of the Catalyst study were dramatic. From 2001 through 2004, companies with the most women directors averaged 42% more pretax net income per dollar of revenue than companies with the fewest female directors. The gap was even wider by other measures: Companies with the most female board membership had a 53% higher return on stockholders' equity and a 66% higher return on invested capital.
- The study noted that it could not prove that women directors caused the superior bottom-line numbers. But the results, which extended across industries ranging from consumer products to information technology, strongly suggested that when women are on boards, profits are good.
- Researchers at Oklahoma State and Loyola reached similar conclusions with regard to the impact of women and minority directors on shareholder value. Focusing on the boards of Fortune 500 companies from 1998 through 2002, the study found that diversity had a positive effect on results as measured by the market value of a company's stock and bonds compared with the replacement value of its assets—a ratio known as "Tobin's q" after the late Nobel economist James Tobin's formula that the higher a company's market value in relation to its asset value is, the stronger is the company's performance. "On average," says David Carter, an associate professor of finance at Oklahoma State, "those with diverse boards did better."

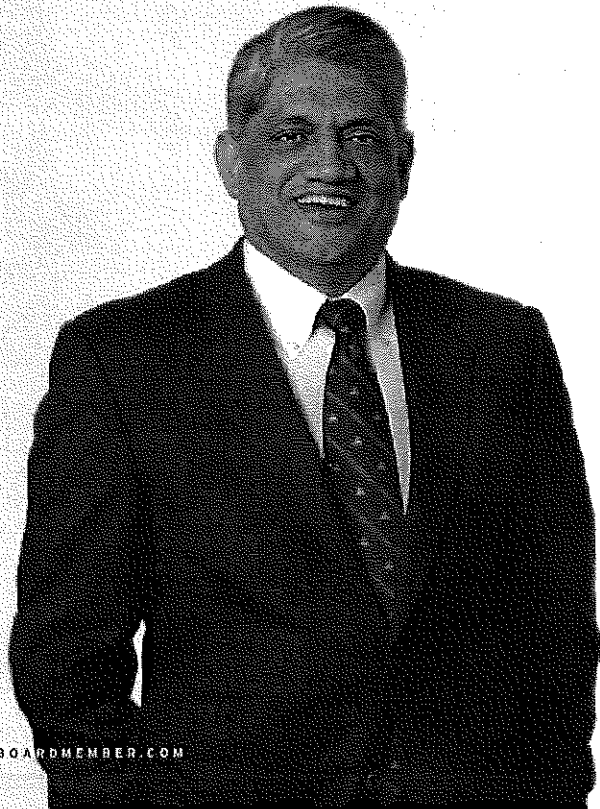
retired CEOs and other ex-senior executives accounted for 16% of new independent directors on the boards of S&P 500 companies in 2008, up from 14% the previous year.

But clearly there are people at other levels who can succeed as board members. Consider what's happened in Norway. There were cries of alarm when the parliament began working on the 40% quota law in 2002, a time when women held only about 7% of board seats. The quota—which had to be met this year—applied to more than 600 companies ranging in size from StatoilHydro, an oil and gas giant with a market cap of more than \$100 billion, to a software firm valued at less than \$10 million. "There was such an outcry when it was first proposed," says Elin Hurvenes, a proponent of the measure who runs a forum that brings together companies and prospective women directors. "Everyone was up in

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Ramani Ayer

Chairman and CEO,
Hartford Financial Services Group



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arms—even women politicians were very much against it."

The law had been proposed as both a matter of fairness and a way to tap talent in a country with more than 70% of working-age women in the labor force—a rate that is among the world's highest. (It's about 60% in the U.S.) Forced to comply or risk being shut down, companies launched Scandinavia-wide recruitment drives. Executive search firm Korn/Ferry International says that for two years before the deadline, virtually every assignment it was given in Norway involved hunting down women directors. Despite opposing the quota as an infringement on private-sector choice, the Confederation of Norwegian Enterprise, a coalition of 18,500 companies, rolled out Female Future—a crash campaign that gave 18 months of lectures and seminars to some 800 promising women candidates, approximately half of whom received board offers. The number of women directors soared from about 250 in 2004 to about 700 at the beginning of 2008.

In some cases, men were booted from boardrooms to make way for the women. Other boards expanded their seats, which in Norway typically range from four to seven per company. Today the quota system remains a controversial fact of life whose business and economic impact has yet to be determined. "We were early in support of more women on boards, because they bring in different views," says Birger Nergaard, 57, CEO and founder of Verdane Capital, a venture firm whose portfolio includes companies subject to the quota. "But I don't like the absolute rule that it should be 40%. Why that? It can cause trouble, because boards become too big."

In the U.S., companies search first and foremost for directors with specific business skills. Diversity is a factor, but not the main one. "I look at core competencies and experiences as being the most critical lens through which you hire directors," says Ramani Ayer, 61, the chairman and CEO of Hartford Financial Services Group, whose 10-member board includes a woman and an African American man. "Diverse sets of candidates are not very abundant in today's very challenging world." Ayer, who is of Indian origin, says he has been turned down "more than once over the past decade" by diversity candidates who were "pretty much up to their eyeballs already."

Diversity should not be confused with social engineering or representative democracy. "The last thing in the world you want is to turn corporate boards into representatives of labor, management, communities, and so forth, all battling for a fixed pie," says Michael Jensen, a Harvard Business School professor emeritus and expert on corporate governance matters. What you do want, he says, is "agreement on ultimate objectives" by all

members of the board. And it's crucial not to lower standards in the name of diversity, says Ayer. "I could not take a midlevel manager and say that diversity trumps experience. You've got to have a senior-level person with the skill and capacity and capability to manage complexity."

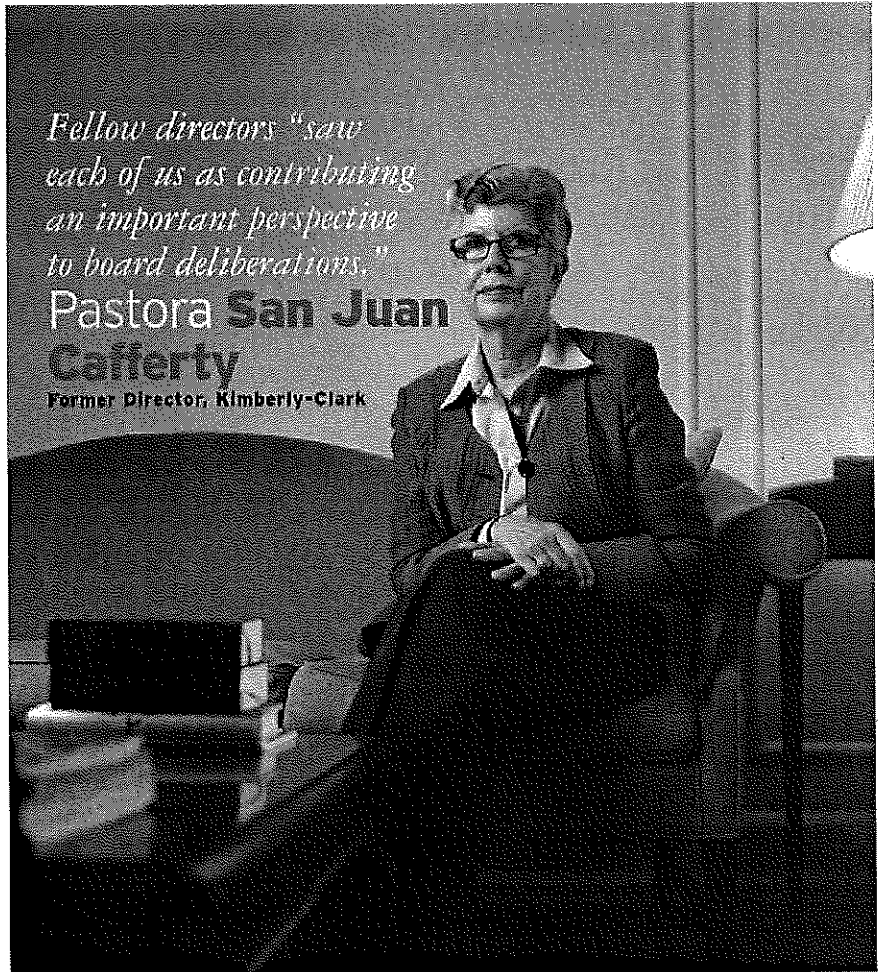
Big investors are pushing for boardroom diversity. Last April, Calpers—the California Public Employees' Retirement System—threw its \$240 billion heft behind a demand that its portfolio companies take diversity into account when choosing directors. "Diversity is a solid business proposition that fosters good governance," Calpers controller John Chiang declared. TIAA-CREF, a \$420 billion pension and insurance giant, has long championed what it describes as diversity of experience, gender, race, and age. "The No. 1 case for diversity is bringing different perspectives to the board," says Stephen Brown, director of corporate governance and senior counsel at TIAA-CREF. Women and minorities hold 16 of the 31 total seats on the TIAA and CREF boards.

Diverse boards may be better able to understand diverse markets. At the Pepsi Bottling Group—the largest bottler of Pepsi drinks, with operations in North America, Mexico, and Europe—40% of the directors are women, 20% are Hispanic, and 10% are African American. By placing a premium on diversity in a global economy, "you're much more likely to build a board that delivers superior

Fellow directors "saw each of us as contributing an important perspective to board deliberations."

Pastora San Juan Cafferty

Former Director, Kimberly-Clark



RECRUITING RESOURCES

These groups will provide assistance when you search for women and minority directors.

- **The Executive Leadership Council** in Alexandria, Virginia, is an organization of African American senior executives. It offers training and networking opportunities to its 450 members and works with companies looking for directors. President and CEO Carl Brooks says the council has put more than 250 members through intensive leadership programs that include a weeklong course sponsored by Kraft Foods Inc. at Northwestern University's Kellogg School of Management. Phone: 703-706-5200; e-mail: elcinfo@elcinfo.com; website: www.elcinfo.com

- **The Hispanic Association on Corporate Responsibility** sponsors a four-day director-development course at Harvard Business School. Carlos Orta, president and CEO of the Washington, D.C.-based group, says more than 180 people have completed the course since 2003 and nearly 10% of the graduates hold board seats. "More and more companies are starting to call us," he says. Phone: 202-682-4012; e-mail: hacr@hacr.org; website: www.hacr.org

- **Catalyst** connects corporations seeking directors with promising female candidates. It gives women executives at its more than 370 member companies and organizations in the United States, Canada, and Europe counsel on how to land board slots. Phone: 212-514-7600; e-mail: info@catalyst.org; website: www.catalyst.org

- **InterOrganization Network** is a four-year-old consortium of 11 regional women's groups, which it taps to help companies find directors. Phone: 215-628-9844; e-mail: info@ionwomen.org; website: www.ionwomen.org

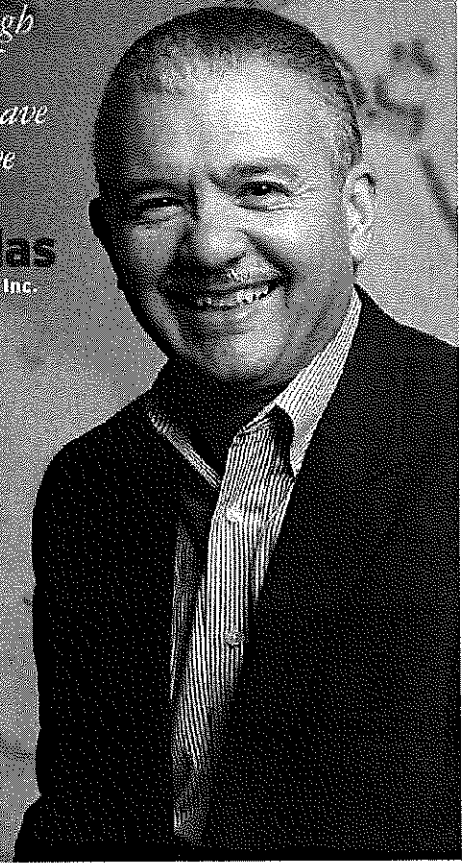
- **The Committee of 100** in New York City works to bring together companies and Chinese American and other Asian American board candidates. Phone: 212-371-6565; e-mail: mlee@committee100.org; website: www.committee100.org

insights," says PBG president and CEO Eric Foss, 50.

At Hartford Financial, Ayer says, board diversity helped lead the company to propose a nationwide public-private partnership to deliver affordable hurricane coverage to people who otherwise wouldn't be insured. At Prudential Financial Inc., whose board members include an African American and a Hispanic American, both men, and two women, including a Chinese American, diversity helped bring about a marketing plan aimed at Latinos. "When you go through life viewing yourself as a minority, you have a different perspective on things," says Prudential director Gilbert Casellas, 56, whose day job is vice-president for corporate responsibility at computer maker Dell Inc. "One of

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Gilbert Casellas
Director, Prudential Financial Inc.



DIRECTOR SURVEY: BOARDS TALK THE DIVERSITY WALK

A survey of directors by *Corporate Board Member* finds that 52% think companies with diverse boards display increased attentiveness to customer needs and enhanced ability to identify market opportunities.

But the poll also spotlights apparent contradictions in director thinking, since only 32% believe that board diversity results in improved company performance. There are other dichotomies too. For one, while more than 62% of the respondents report that their boards track shortfalls in their own diversity, only 45% say their

boards went out of their way to recruit the minority members now on their rolls.

Directors also send a mixed signal about the need to hire minority workers. More than 54% say that their boards support employee diversity. But those boards don't review the companies' current hiring practices, nor do they set any formal plans or goals for minority hiring.

Seventy-five board members answered the survey, which was conducted by e-mail.

Do you believe that diversity on a board increases attentiveness to customer needs?

YES
52%
NO
36%

Increases a company's ability to identify new market opportunities?

YES
52%
NO
33%

Improves company performance?

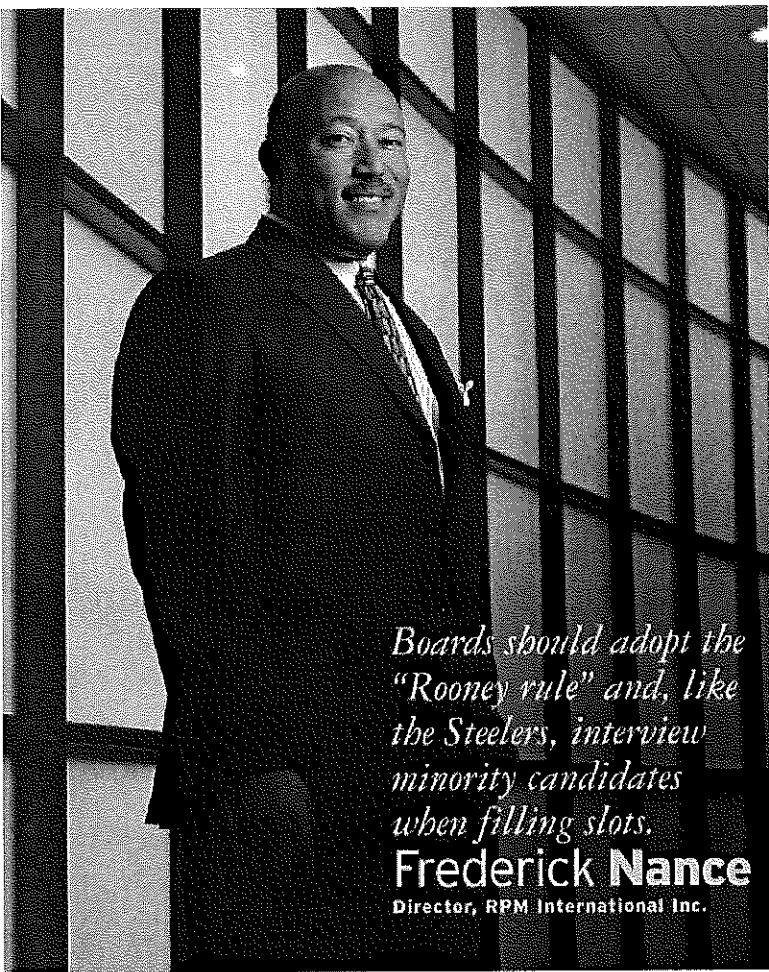
NO
39%
YES
32%

Reduces the probability of shareholder suits?

NO
61%
YES
17%

Reduces the probability of employee suits?

NO
55%
YES
20%



Boards should adopt the "Rooney rule" and, like the Steelers, interview minority candidates when filling slots.

Frederick Nance
Director, RPM International Inc.

the perspectives I offered was that we should target our outreach to Latino community organizations."

Women also bring a different perspective, says Gail Deegan, 62, who chairs the audit committee at EMC Corp., a Fortune 500 producer of electronic data-management systems that has no other women and no minorities among its 11 directors. Women tend to be more collaborative and have less of a command-and-control style than men, says Deegan, a former chief financial officer of book publisher Houghton Mifflin. Moreover, "70% of the economy is driven by the consumer, and if you break that down, how many of the decisions are made by women?"

Decision-making may be particularly skewed toward women among African Americans. Bureau of Labor Statistics data show that 67% of African American households were headed by women in 2006, compared with 53% for whites, 50% for Hispanic Americans, and 45% for Asian Americans.

So how should boards that want to diversify proceed? Adopting something like the National Football League's "Rooney rule" would be a good idea, says Frederick Nance, 55, regional managing partner in the Cleveland office of law firm Squire

Sanders & Dempsey LLP. Nance, an African American, is a director of RPM International Inc., a Fortune 1,000 maker of specialty chemical products whose 13-member board has an African American woman as well. The rule, named for Pittsburgh Steelers co-owner Dan Rooney, calls for teams to interview minority candidates when filling coaching slots.

Above all, companies need to look beyond the CEO's office in searching for directors, says Deborah Soon, vice president of marketing and executive leadership initiatives at Catalyst. She says that women who head major corporate divisions form "a ready feeder pool" to draw from but may go unnoticed, since their jobs aren't listed in company annual reports.

Vicki W. Kramer, a Philadelphia management consultant who led a 2006 study of Fortune 1,000 boards for Wellesley Centers for Women, says a board benefits most from women when at least three of them serve on it. "Having one of anybody makes the person stand out and be more careful and likely to hang back," she says. But when three women are directors, the study found, "having women on the board becomes a normal state of affairs."

Pastora San Juan Cafferty, 68, served for more than 30 years on the board of consumer paper-products maker Kimberly-Clark. Other women and minority members served with her. Fellow directors "saw each of us as contributing an important perspective to board deliberations," she says. The insights that flow from such perspectives are what diversity is all about. ☺