Harvard Law School Forum on Corporate Governance

Addressing the Challenge of Board Racial Diversity

Posted by Cydney Posner, Cooley LLP, on Tuesday, September 8, 2020

Tags: Board composition, Board dynamics, Board leadership, Boards of Directors, Diversity, ESG, Social networks, Surveys
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> **Editor's Note: Cydney S. Posner** is special counsel at Cooley LLP. This post is based on a Cooley memorandum by Ms. Posner. Related research from the Program on Corporate Governance includes **Politics and Gender in the Executive Suite** by Alma Cohen, Moshe Hazan, and David Weiss (discussed on the Forum **here**).

After taking up the challenge of increasing board gender diversity, companies are now increasingly facing the challenge of achieving board racial diversity. Recent social unrest over systemic racial injustice has pushed racial inequity into sharp relief, leading many companies to consider actions they could take to implement the needed systemic transformation. Because, as it's often said, change starts at the top, one approach has been to increase the number of African-Americans represented on boards. This recent **paper** in the *Harvard Business Review* asks "Why Do Boards Have So Few Black Directors?" And the "**Black Corporate Directors Time Capsule Project**," a survey undertaken by Barry Lawson Williams, a retired director who has served on 14 corporate boards, seeks to "capture the experiences" of 50 seasoned Black directors "for the benefit of the next generation of Black corporate directors." The survey, which in part addresses the issue of recruitment of Black directors, is also replete with other great observations and advice, too extensive to cover in full here, including advice for aspiring directors.

Although, given that it's not required to be reported, it can be difficult to obtain data about the racial composition of boards, according to ***Bloomberg***, about "a dozen of the largest companies by market value in the S&P 500 Index have no Black board members." What's more, *Bloomberg* reports, "the number of Black corporate directors has stalled or even declined. Although about 10% of directors at the 200 biggest S&P 500 companies are Black, according to executive recruiting firm Spencer Stuart Inc., the firm says the percentage of Black executives joining boards in 2020 fell to 11% from 13% the year before." By comparison, "[w]omen—most of them white—now hold 28% of all board seats at major corporations, according to Bloomberg data," and last year a milestone was reached: the elimination of the last all-male board among the S&P 500. (See **this PubCo post**) What accounts for the difference? Some attribute it to the determined push for board gender diversity by institutional holders, such as BlackRock (See **this PubCo post**) and State Street (see **this PubCo post**), along with legislative mandates, such as California's SB 826 (see **this PubCo post**). These same institutions are now including racial diversity as part of their social responsibility portfolios, and new bill, **AB 979**, has been introduced in California, designed to do for "underrepresented communities" on boards of directors what SB 826 did for board gender diversity (see **this PubCo post**). But will that do it?

SideBar

Like SB 826, California's AB 979, if passed and signed into law, would require, no later than the close of 2021, that a "publicly held corporation" (that is, a corporation with outstanding shares listed on a major U.S. stock exchange) with principal executive offices (according to its Form 10-K) located in California, *no matter where it is incorporated*, have a minimum of one director from an underrepresented community. A director from an "underrepresented community" means a director who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native. The bill would require, no later than the close of 2022, that a corporation with more than four but fewer than nine directors have a minimum of two directors from underrepresented communities, and that a corporation with nine or more directors have a minimum of three directors from underrepresented communities. The bill would also require, on or before specified dates, that the Secretary of State publish various reports on its website documenting, among other things, the number of corporations in compliance with the bill's provisions. As with board gender diversity, the bill may compel companies to look outside their traditional channels to find new directors from underrepresented communities.

Background

In the *HBR study*, the authors analyzed a survey of a 1,000 directors conducted during 2015 and 2016 to gain an understanding of the institutional and social barriers that "that perpetuate the continuing underrepresentation of Black professionals on boards." Only 24 survey respondents identified as Black/African-American—a rather telling fact on its own—so the sample is necessarily small. The *Williams survey* was conducted on the author's own initiative with a goal of capturing the experiences of seasoned Black directors, as a number were retiring from boards. Williams developed a survey of 40 questions asked in 1 to 1½ hour interviews of 50 seasoned Black corporate directors, whom he selected on his own. These directors served on an aggregate of 274 corporate boards in their careers, and over 60% of the directors had served on five or more boards. The participants were 74% male, 26% female and split geographically 42% east coast, 32% west coast and 26% central.

Gaining introductions

The authors of the *HBR study* concluded the racial status quo on boards is reinforced by the process for recruiting new directors. The study found that, when recruiting to fill open board positions, boards that do not include any directors who are racial/ethnic minorities consider almost no candidates who are racial/ethnic minorities (0.2 candidates per open vacancy, on average) and fewer total candidates (2.9, on average). By comparison, boards that include two or more directors who are racial/ethnic minorities consider an average of 1.0 racial/ethnic minority candidate and 3.9 candidates for each open board seat. The authors suggest that even invocation of the Rooney Rule (a policy originally created by the National Football League to increase the number of minority candidates considered for head coaching and general manager positions, which requires that at least one racial/ethnic minority candidate be included in every pool from which nominees for open board seats selected) may not suffice: "studies indicate that these rules often do not go far enough. Finalist pools need to have more than one candidate from an underrepresented group to meaningfully influence hiring outcomes."

But how do prospective candidates gain initial introductions? The *Williams survey* found that Black directors were nominated to boards primarily "because of business, community or other board relationships"; the author found that 85% of board searches did not involve an executive search firm and only 17% of first board appointments were made primarily through executive search firm contact. Black directors indicated that race played a major role in only 14% of board searches; rather, having the desired skill set and experience as a corporate executive were the most significant factors. An important pipeline, the *Williams survey* showed, was service on a non-profit board, which provided experience in how boards function, collaboration skills, "how to listen and express their voice," and additional skills and leadership experience as well as access to new, potentially influential, relationships. Civic, industry and government involvement were also mentioned as possible pipelines. In the *Williams survey*, when respondents were asked what they wished they done differently, although it was important to "avoid being considered a single-issue director," the "primary thing most Black directors would have done differently was to promote diversity more and sooner, including getting off boards that lacked a clear commitment." Most respondents in the *Williams survey* expected that relationships would continue to be the most important avenue for being nominated for board service over the next five years.

The *HBR study* also found that social networks were the primary method of introduction. Over half (54%) of Black directors were known to a fellow board member prior to being appointed (33% known to the CEO), while that was the case for only 35% of white directors (31% known to the CEO). Executive search firms were used to recruit 33% of Black directors, but only 25% of white directors. According to one Black director, in selecting board members, "people tend to go to people that they're familiar with [and] have grown to know and trust. Often, people don't have very diverse circles of people that have that level of trust and confidence." Accordingly, recruiting through social networks can have the negative effect of "perpetuat[ing] long-standing racial inequities." And the internal pipeline does not seem to be an effective springboard for Black directors: none of the Black directors in the *HBR study* were current or former executives of the company, while 12% of white directors had occupied those positions.

SideBar

This paper from the Rock Center for Corporate Governance at the Stanford Graduate School of Business looked at C-suite (CEO and direct reports) demographics to get a better handle on the "actual pipeline, as it stands today, for next year's newly appointed CEOs and future board members." Although there has been some effort to encourage boards to expand their searches outside the traditional box, the authors maintain that, for a board seat, the candidate usually needs "CEO, operating, or senior finance experience. In their study, the authors found that

> *"[r]acially diverse executives hold only 16 percent of total C-suite positions. Only 16 [of the Fortune 100] have a non-white CEO. Twenty-six of the Fortune 100 have no ethnic diversity at the C+1 level [direct reports], and 6 have no ethnic or gender diversity at this level….Similar to our finding above, we find that ethnically diverse executives have lower representation in positions that directly feed into future CEO and board roles—although the degree to which this occurs is much lower than it is among female executives. Racially diverse executives hold only 13 percent of high potential positions (CEO, CFO, and P&L), and 20 percent of lower potential positions. The very low prevalence of nonwhite CFOs accounts for almost all of this skewing….Twenty-six companies have no racially diverse executives in the C-suite. Non-white executives comprise a third or more of the C-suite in only 13 companies, 40 percent or more in only 5 companies, and half or more in only 2 companies."*

From these findings, there is no getting around the uncomfortable conclusion that the levels of diversity in the C-suite are inadequate to provide a real pipeline to some version of parity among corporate leaders. This deficiency is particularly striking with regard to the paucity of diverse executives in roles that the authors identify as "most likely to be prime candidates for advancement." (See **this PubCo post**.)

Consistent with the Rock Center study, as reported in this ***Bloomberg* article**, a study by recruiting firm Korn Ferry also showed that less than 10% of P&L positions at the largest U.S. companies, a major pipeline to CEO and board positions, were held by Black executives. In addition, only about 1% of board members in the S&P 500 were Black directors, and 37% of boards did not have any Black directors. In addition, according to the study, "Black executives who did get operating jobs said they faced headwinds such as pre-conceived notions of their abilities and exclusion from corporate social circles….They also said they were asked to take on disproportionately risky projects, which had a high likelihood of failure, to prove their abilities."

Training and education

The *Williams survey* showed that almost 80% of directors looked primarily to the Black Directors Conference for networking and education. A little over half of the directors responding to the *Williams survey* said that they did not a particular role model, while about a third said that they did; almost 70% said that they did not have a board sponsor.

The *HBR study* found that onboarding processes, such as new director training—viewed as necessary to incorporate new members effectively and secure the benefits of diverse points of view—was considered more effective in directors in boards with two or more racial/ethnic minorities (66% to 44% for white-only boards).

Board leadership

Notwithstanding stronger academic qualifications, as well as comparable experience and time commitments to board functions, Black directors were substantially less likely to hold leadership positions on boards, according to the *HBR study*. Only 25% of Black directors were board chairs or lead directors, compared to 37% of white directors and only 42% were committee chairs (including the nominating committee, which controls board nominations) compared to 52% of white directors in the *HBR study*.

According to the *Williams survey*, about 80% of respondents served on either or both the Audit (the best committee to learn the business, so a good starting point, according to the author) and Nom/Gov committees ("where the power is"), and almost half served on the comp committee (the best committee "to get to know the CEO"). Several of the directors emphasized the importance of serving on a committee where the director could in time become chair.

Board dynamics

In the *Williams survey,* 37% of respondents thought that they were treated differently from other directors (although apparently some of the Black women directors could not distinguish whether treatment differed as a result of race or gender.) Some of the specific comments provided in the *Williams survey* were that the director "could say something and get no reaction until someone, non-minority, later said the same thing [hmm, sounds familiar], was "treated as the spokesperson for diversity" and "felt some people were not used to treating Blacks as a peer." In addition, according to Williams, "almost ⅔ of Black corporate directors who responded to this question indicated that they had to address certain issues differently because they were a Black board member, mainly diversity issues."

The *HBR study* found that "Black professionals frequently find that their contributions are ignored and undermined—an issue that can be particularly acute for Black women…. Although most [Black] directors rated their boards' dynamics highly with respect to having their voice heard [91%], feeling in sync with other board members [88%], and performing as a team [92%], ratings were notably lower in one particular scenario: when a Black director was the only racial/ethnic minority on the board" [78% in each case].

Benefits of board diversity

Respondents in the *Williams survey* identified "their most important contributions [as] providing different points of view, providing finance and regulatory advice, and promoting diversity." The *HBR study* also concluded that boards with greater racial/ethnic minority representation benefit from the introduction of a broader range of perspectives that can help shape board decisions. More diverse boards were also more likely to prioritize diversity within the company and to nominate more racially-diverse directors. Boards with two or more racial/ethnic minority directors were more likely to respond that the board has an ideal mix of members with diverse perspectives and experiences (77%) and that company diversity was a high priority (69%) compared with boards with no racial/ethnic diversity (53% and 34%, respectively).

SideBar

The **PwC 2019 Annual Corporate Directors Survey** showed that substantial majorities of respondents said that board diversity "brings unique perspectives (94%), enhances board performance (87%) and improves relationships with investors (84%). More than three-quarters (76%) also agree that board diversity enhances the performance of the company." (Notably, however, the survey also found that only 34% of directors said that gender diversity is very important to their boards, and only 26% said the same about racial/ethnic diversity (a decline from 34%).)

According to **this article**, research by Vontobel Asset Management showed that, among the S&P 150, the companies with the most ethnically diverse boards performed better. The research found that "companies with the most ethnically diverse boards, on average, achieved a higher proportion of their business in international sales and generated a higher five-year EPS growth than companies with the least diverse boards." More specifically, the 25 companies with the most diverse boards (38% minority directors on average) reported an average five-year EPS growth of 18%, while the 25 least diverse (7%

minority directors on average) reported 12% EPS growth. The most diverse business sectors were healthcare and IT (six IT companies), but interestingly, IT was also prominent (five IT companies), along with real estate, among the least diverse sectors. The study authors found more diversity at companies with potential for more international business, while real estate tended to have a domestic focus. Over half of the top 25 companies were consumer-facing.

Forecast

Most respondents to the *Williams survey* predicted either no change or a slight increase over the next five years in the number of Black corporate directors, with some believing there would be a slight increase mostly for Black women. Those predicting some type of increase based their views on an increased availability of Black executives, legislation such as proposed AB 979 in California, pressure from proxy advisors, institutional shareholders and other outside organizations, term limits and increased opportunities for Black women. Of the directors who expected no change over the next five years (26.7%), their views were premised largely on anticipated changes in politics and the loss (presumably through retirement) of a number of multi-boarded Black directors. Respondents to the *Williams survey* "expressed significant desire" to be considered for corporate boards of consumer products, technology and airline companies and "questioned why they have not been approached more for venture capital / PE backed boards."

Action items

The *HBR study* authors recommend that, in addition to setting the right tone at the top, boards can take the following steps to catalyze change:

- *Assessment and revision of director recruitment procedures*. The *HBR study* authors acknowledge that change here may require careful, and potentially painful, self-reflection. The authors suggest the following questions:
- *"How many candidates are typically evaluated for open board seats? How frequently are new directors brought on board? (In response: Can the board set a minimum number of candidates to interview for each opening? Is a formalized board refreshment policy, such as a mandatory retirement age, needed?)*
- *To what extent do directors rely on personal connections to identify director candidates? What is the demographic composition of directors' professional and social networks? (What professional organizations, search firms, or connections can be consulted to access a more diverse pool of candidates?)*
- *What factors are used to rule candidates out? Is a desire for 'cultural fit' within the board resulting in a racially-homogeneous board? (How can decision-making processes and criteria be established and formalized?)*
- *Is former CEO/CFO experience a necessary prerequisite for board membership? (What are the specific skills and capabilities that are needed by the board? What experiences and perspectives are not yet represented?)*
- *Is the board setting new directors up for success? (What processes and activities can be used to build relationships between new and existing directors?)"*
- *Accountability*. Directors should make sure that, when the CEO position needs to be filled, a diverse pool of candidates is considered. directors should also have a process in place to hold company executives responsible for diversity in the "talent pipeline." The *HBR study* notes that some companies link executive comp to achievement of diversity targets and also offer employees referral bonuses.
- *Mentoring and sponsorship*. Formal mentoring and sponsorship can be useful in offering valuable connections for racial/ethnic minorities, such as recommendations for other available board opportunities. The authors emphasize that "it's important for all directors—not just people of color—to engage in these activities."

SideBar

According to **this article** in the *NYT*, although experts suggest that, as recommended above, one way to enhance diversity is to tie executive compensation to diversity goals, that's rarely done. Citing data from compensation consultant Pearl Meyer, the article reports that only “78 of roughly 3,000 companies said fulfilling diversity goals determined some portion of chief executives’ pay.” In some cases, the compensation at issue may not be significant enough to make a difference or the goal may not be sufficiently challenging. The Pearl Meyer data indicated that only 11 of the 78 companies “revealed the share of pay affected by fulfilling diversity goals, and 21 gave some details of their diversity goals.” However, the article indicates that the topic is, at least, on the table for discussion at a growing number of companies. The article suggests that including diversity as a performance goal in compensation would not only demonstrate corporate commitment to diverse and inclusive workplaces, but it could also “provide a public scorecard that employees and shareholders could use to determine whether companies were following through on their commitments.”

In the *Williams survey,* respondents identified the most significant wisdom they gleaned from board service regarding how to be most effective as a board member, all of which would be certainly be essential in promoting board racial diversity from the inside: to “be more collaborative, learn how to make contributions, and to speak up. The most important factor in being effective on boards starts with the relationship with the CEO/Lead Director.” Additional keys to being effective were good committee assignments (such as the nom/gov committee), making contact with other directors between meetings, chairing a committee and building relationships with other board members.

The *Williams survey* offered ten key takeaways to help increase racial diversity on boards:

1. *“We need to identify more potential Black candidates for board service and train/mentor them (especially women candidates).*
2. *We need to build alliances with other minority groups in our push for board diversity.*
3. *We must strengthen the legislative, regulatory, and institutional routes to apply pressure for board diversity.*
4. *We need to strengthen the efforts of executive search firms regarding diversity.*
5. *We need to get more candidates for board service in leadership positions on not-for-profit boards (and civic and industry organizations).*
6. *We need to get more existing Black corporate board members onto the Nominating & Governance committees.*
7. *We have to support existing Black corporate board members in their diversity efforts (including in procurement and philanthropy).*
8. *We need to target technology, consumer products and airline boards to provide more opportunities for board service.*
9. *We need concerted efforts to approach the VC & PE communities to provide more board opportunities.*
10. *We need CEO’s, Lead Directors and Chairs of Nominating & Governance committees to meet aspiring Black candidates for corporate boards.”*

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