

# Improving diversity at US public companies:

Seek and you shall find



The movement to improve board diversity crosses state and international borders. In 2016, the California State Teachers' Retirement System, Ohio Public Employees Retirement System, Netherlands-based APG Group and UK-based Legal & General Investment Management began working together to engage 58 S&P 500 companies in discussions around board diversity, evaluation and refreshment.

This coalition of global investors have a combined total of US\$2.5 trillion in assets under management at the time of publication.

The coalition began by sending a letter to each of the 58 US-listed companies sharing examples of good practice around nomination committee charter and proxy statement disclosure, board refreshment processes and milestones for change. Many of the 58 companies responded to the letter, often by proposing a discussion with an independent director.

The coalition's immediate engagement focus was to understand whether board composition, nomination and refreshment processes were conducted in an open discussion format. By using this format, companies experienced a comfort level that steered them to initiate conversations on barriers, challenges, and their perceived difficulties related to overall board governance. The breadth of these conversations helped the coalition to better understand company perspectives. Significantly, companies held a near-unanimous view that they want to see improvement in board diversity.

The coalition shared the insight that investors value proxy statements with specific information on their board skill-set matrices, succession planning and refreshment—even expanding to their employee diversification efforts. As of 1 January 2019, 44 of the 58 companies have appointed women to their boards and many of these companies also updated their nominating

committee charters or corporate governance principles to include specific best practices; for instance, using an external search firm to expand the pool of board candidates considered.

## Common governance values & empirical evidence

Diversity as a strategic enabler is a priority shared by all members of the coalition. The decision to engage companies in the S&P 500 was itself strategic; companies with no women on their boards are outliers in the S&P 500. Thus, the 58 companies were chosen based on having either no women or only one woman on their boards. In addition, the companies had a significant number of long-tenured directors.

Numerous academic and industry studies have shown a correlation between board gender diversity and company performance. For instance, MSCI's 2016 study, **The Tipping Point: Women on Boards and Financial Performance**, revealed that adding any number of women to a board of directors was correlated with higher median increases in earnings per share compared to losing women from the board during the period 2011-2016.

In 2016, Credit Suisse updated their **The CS Gender 3000: The Reward for Change** report to include close to 3,400 companies. A review of the data indicates that excess compound returns have expanded to 3.5% per annum since 2005, for market cap companies >US\$10 billion, with one or more women on their board compared to companies with all male boards.

## Improving boardroom performance: define diversity

As noted, the coalition learned first-hand from companies that they face challenges with overall board governance. Continued engagement by the coalition, whether through the boards' independent directors, nominating committee members or management is essential to boards' success. Every board vacancy is an opportunity to enhance the mix of experience and perspectives. In fact, most of the coalition members are either signatories or endorsers of the **Investor Stewardship Group's Corporate Governance Principles**, which state in part: "...a well-composed board should also embody and encourage diversity...". The ability to take advantage of every opportunity requires a proactive and well-structured board recruitment process. Key areas for recruitment the coalition discussed with the 58 companies included individuals who reflect the nature, scope and aspirations of the business as well as its long-term strategy, and competencies and experience across relevant sectors of the economy.

The 2016 NACD Blue Ribbon Commission Report on **Building the Strategic-Asset Board** outlines seven areas—similar to those endorsed by the coalition—to enhance the range of diversity in the boardroom.

## Shareholders and companies working together

Companies should actively assess and disclose in their proxy the board's current mix of skills and backgrounds and how they align with the company's forward-looking strategy to create and sustain value. Regularly evaluating current skills and any possible emerging skill gaps is an important element of board talent maintenance. Full board evaluation is a way to proactively identify prospective desired skill sets or competencies for future board recruitment. A proactive stance serves investors' interests as well—knowing the nominating committee has considered investors' concerns prior to proxy season may build confidence when the slate of directors is announced.

Another topic for discussion is whether a company might affirm its commitment to diversity. The affirmation could be included in board governance policies, such as the nominating and governance committee charter, and could include a commitment to identify qualified candidates of diverse backgrounds.

The coalition also asked companies to consider procedures by which women and individuals of diverse racial and ethnic backgrounds are identified for consideration in every search for a board nominee. [This is sometimes referred to as the **Rooney Rule**; named after Dan Rooney former owner of the US football team the Pittsburgh Steelers who spearheaded an effort to diversify the coaching staff.]

The fourth topic of discussion was that candidate searches consider individuals from corporate backgrounds beyond the executive suite, and non-corporate backgrounds such as academia, government and non-profit organizations. Most of the 58 S&P 500 companies engaging with the coalition responded openly and positively to the dialogue.

## Moving forward

In 2018, two international institutional investors joined the group of four: UK-based RPMI Railpen and Netherlands-based PGGM.

The addition of these investors enabled the coalition to extend its discussions to 14 more US companies with less diverse boards and a high proportion of long-tenured board members.

So far in 2019 we have sent letters to 37 companies and seven companies have appointed a woman. The group shall continue to follow up with those companies that have not yet responded to the original letter and also to continue to engage with those companies that have not so far made any material changes.

## Contact us

For further information on anything you have read here or to provide feedback, please contact us at:

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