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Diversity in the Boardroom
Article 3
The case for and against

Introduction

Diversity in the boardroom has been a hot topic in recent years. Does the traditional boardroom of a fairly homogenous group of individuals really produce the most effective decisions and strategy for a company? Does such a boardroom have exposure to a wide enough range of perspectives to facilitate robust discussions of issues that arise? Is there something missing?

This article is part of a series that explores diversity in the boardroom. To view the other articles in this series, visit the Deloitte Africa Centre for Corporate Governance.

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Article 3

The case for and against diversity in the boardroom.

Why would a company consider board diversity?

The principal argument in favour of a diverse board is the wide range of perspectives that each individual would bring to the boardroom table. Principle 3.1 of the ICGN Global Governance Principles supports this view and states that the composition of the board should reflect a sufficient mix of individuals with relevant knowledge, independence, competence, industry experience and diversity of perspectives to generate effective challenge, discussion and objective decision-making.

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A diverse board better understands its customer base and the environment that the business operates in. As a result of this enhanced understanding, the board is better placed to find and seize opportunities for innovation, which ultimately creates value for the business. For example, in 2014 Walmart appointed 30-year-old Kevin Systrom, former CEO and co-founder of Instagram, to its board of directors. The company considered Kevin's technical and digital expertise to be invaluable as they planned to further connect with customers and deploy new capabilities through e-commerce and mobile channels. [1] The enhanced understanding also means that the board is able to react faster to changes in the environment. Where directors don't properly understand the market and applicable business environment, it can take a long time before the board is convinced and comfortable enough to make important decisions. This delayed reaction time to market changes can be paralysing in highly competitive markets where a company's longevity depends on its ability to respond and adapt quickly.

Having a wide range of perspectives in the room also means that the status quo is constantly challenged and critically reassessed, which guards against the notorious "group think". And although this may initially lead to "storming" around the boardroom table, it is likely to yield a more favourable result for the company ultimately. Interestingly enough, experts believe that

due to group bias, "homogeneous groups don't come to better solutions - they're simply convinced that they did. Heterogeneous groups, on the other hand, come to better solutions - they just don't think that's the case." [2] Research by Columbia University's Katherine W Phillips and others revealed that diverse groups outperformed more homogeneous groups not because of a flurry of new ideas, but rather that the heterogeneity prompted a more careful evaluation of the information at hand, which was absent in homogeneous groups. [3] For example, research by Professor Aaron Dhir of York University into the experiences of a group of Norwegian corporate directors post the introduction of the 40% gender quota revealed that female directors are "more likely than their male counterparts to probe deeply into the issues at hand" by asking more questions, leading to more robust intra-board deliberations. [2] Another insightful finding from Professor Dhir's study was that the gender quota eroded at cliques being formed amongst the directors and forced people to tap outside of their own networks. Consequently, the more diverse a board becomes, the wider the networks and business connections that such a board has access to.

A spectrum of diverse perspectives in the boardroom, specifically with regard to skills and expertise, also aids to counteract "silo thinking" when the board is faced with a challenge. A board that is equipped to consider an issue from many angles (e.g. financial, economic, legal, generational, geographic, etc.) is far more effective at assessing the risk of such an issue than one that adopts a one-dimensional approach.

Incorporating independence into the boardroom also has its own specific advantages. Independent directors bring an unbiased view distinct from that of shareholders and management which provides reassurance to external parties that the company is being run in an effective manner. Due to their perceived distance from the company, they act as a balancing element in boardroom discussions between different shareholder representatives and managing conflicts of interest affecting board members. Their objectivity also allows them to safeguard the interests of minority shareholders and other stakeholders who may not be represented on the board and who may be unable to speak with a strong voice at shareholder meetings.

Having considered the above, the question is whether there is evidence of enhanced company performance as a result of incorporating diversity into the boardroom. Currently, studies of this nature are largely focused on the benefit of gender diversity in the boardroom, but the same arguments may equally apply to all forms of diversity. According to the World Economic Forum [4], compelling findings regarding the benefits of gender equality are emerging from companies. It says companies that include more women at the top levels of leadership tend to outperform those that don't. Findings from studies performed by Catalyst [5] showed that companies with a higher representation of women in top management, outperformed their counterparts with respect to Return on Equity and Total Return to Shareholders. More recent studies [6] have supported this, not only when looking at women in the boardroom, but also women executives and senior management.

A further benefit of having a diverse board is the external perception that may be created. A company that embraces diversity in the upper echelons of the organisation may be perceived by outsiders to adopt a top-down approach to being a good corporate citizen. Such a view may inspire investor confidence in the organisation which ultimately creates value for the company.Lastly, seeing the positive impact of having a diverse board as mentioned above, in itself creates an incentive for companies to continue incorporating diversity in the boardroom. Boards that strive for effectiveness and embrace diversity as a mechanism to deliver that effectiveness are likely to perform better than boards who incorporate diversity with compliance in mind ("tick-boxing"). It remains important for boards to strive to create a balance between conformance and performance. While it remains necessary to ensure compliance and adherence to various statutory prescripts (which may differ from jurisdiction

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to jurisdiction) and applicable governance codes, the focus should always be on the performance of the business. A tick-box approach to compliance or conformance will not necessarily yield positive results. Rather, companies should strive for a balance and determine how conformance can be viewed in a positive light to enhance the performance of the business. For example, consider a company that appoints a single director who possesses various elements of diversity to a fairly homogenous board - purely as a conformance exercise so the board can "tick a few diversity boxes". Such a director may be outvoted by the other board members, thus diminishing the performance benefit of having the diverse member on the board. In the above situation, the company should carefully consider how best to incorporate diversity in the boardroom in a way that will effectively improve the performance of the business. This might involve including other members on the board with elements of diversity (bearing in mind the necessary skill, experience and expertise requirement) to result in a more balanced board which makes effective decisions for the company.

Why might a company not adopt diversity in the boardroom?

The benefits of having a diverse board must be weighed up against the costs of doing so. Finding the appropriately skilled individuals who also match other desired elements of diversity can be a difficult, time consuming and expensive task. This is especially true for boards operating in niche industries where highly specialised skills are required, causing the pool of potential board candidates to be reduced. Where a company places a greater emphasis on other aspects of diversity rather than the skills and expertise of an individual, it could run the risk of fronting or making such individuals feel disenfranchised from the greater board.

Where a company does manage to find appropriately skilled individuals to constitute a diverse board, it may initially find that board members need to earn each other's trust in decision making as each person comes with a unique approach and perspective. This may result (at least initially) in more prolonged decision making, reduced cohesion and additional conflicts initially and, if improperly managed, could lead to distrust and dissatisfaction in the boardroom. [2]

A further argument against heterogeneity is that it reduces overtime as members become more familiar with each other. The more board members interact, the more similarly they think which takes one back to the initial problem of "group think". Given this phenomenon, regular board refreshment is of paramount importance. The board should be refreshed often enough to ensure that the appropriate level of debate and challenge is maintained in the boardroom, but not so often that it prevents synergies from being created between directors. In this regard, the King III recommendation that at least one third of nonexecutive directors be rotated annually provides an ideal opportunity for the board to ensure regular refreshment.

Lastly, particularly in smaller family-owned companies, there may be a reluctance to introduce diversity into the boardroom as it may require the inclusion of "outsiders" into the company. For example, a company may be hesitant to introduce a larger proportion of independent directors to the board as major shareholders may feel that they are relinquishing ultimate control of the board. However, this may not be the case where the majority shareholder can influence the appointment or removal of directors. Major shareholders can ensure that they only approve the appointment of independent directors that share their vision for the company - the involvement of outstanding independent directors can then only enhance boardroom capabilities and the likely success of the enterprise. In such a scenario, one has to caution against the appointment of "puppet directors" as one should not ignore the obligation of each director to continuously comply with their fiduciary duty, i.e. to always act in the best interest of the company.

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