

# Current Standards for Board Diversity

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Incorporating diversity into the composition of the board and its committees is, by this point, a recognized governance best practice. It is a duty that should be formally recognized in the charter of the board's nominating committee.

But the near saturation-level emphasis on diversity threatens to obscure the underlying value to the organization of a diverse board, and how such diversity relates to other elements of the board's workforce culture oversight obligations. Informed board orientation on the scope of the practice, the rationale for its implementation, and its relationship to other fiduciary duties can mitigate against this risk.

## Rationale for "Best Practice"

Both of the leading statements of governance principles—Business Roundtable (BRT) and the "Commonsense Principles" series—strongly endorse the establishment of diversity standards for governance.

For example, BRT recommends that boards "develop a framework for identifying appropriately diverse candidates that allows the nominating/governance committee to consider women, minorities, and others with diverse backgrounds as candidates for each open board seat." The Commonsense Principles series recommends that directors have "complementary and diverse skill sets, backgrounds, and experiences," and that director candidates be drawn "from a rigorously diverse pool."

Similar support is provided from across the corporate spectrum, including asset managers, institutional asset owners, employee groups, public policy organizations, and other stakeholders. These and other, similar groups and organizations are placing significant pressure on companies with which they have influence to address board diversity and to demonstrate support for gender diversity improvements.

Then there is the statutory effort, as represented by the new California law that requires *public* companies headquartered in the state to maintain a prescribed level of gender diversity. The new law provides for an escalating level of women on the board, with at least one woman member by December 31, 2019, and by December 31, 2021, at least two women (for boards with five or fewer directors) and three women (for boards with six or more directors). Penalties are applicable for non-compliance.

## The Scope of Diversity

Hospital and health system directors should be aware that most of the relevant descriptions of this best practice seek to extend diversity in a broad sense and not just to matters of gender. This reflects an expectation that the value provided by those with experience with the company's business should be balanced by the ideas, insights, and contributions provided by those who offer other experiences. Oftentimes, those different experiences reflect unique matters of ethnicity, race, and other elements of diversity.

For example, BRT's perspective is that more diverse boards—including directors who represent the *broad range of society*—will strengthen corporate governance. In addition, the newly released Commonsense Principles 2.0 specifically added reference to *diversity of thought* as a critical element of diversity. Furthermore, matters of age (and especially, relative youth) are increasingly playing an important role in the composition of the governing board.

## The "Business Case"

There is a consistent theme across all variations of the board diversity best practice that diversity along multiple dimensions and backgrounds serves to strengthen the performance of a board of directors. As BRT emphasizes, "The diversity of thought and perspective within our society accounts for much of its resilience and strength—and it adds to the abundance of good decision making. Differing perspectives and maintaining respect for the individual enable Americans, as well as American corporations, to prosper."

## Key Board Takeaways

- Make sure that diversity criteria are incorporated into the board nominating committee process.
- Confirm that the nominating committee applies "diversity" to include matters of ethnicity, age, and background, as well as gender.
- Ensure that the board is aware of the data supporting the perspective that diversity strengthens the performance of the board.
- Evaluate the board turnover record and the effect it may have on opportunities for increasing board diversity.
- Recognize that addressing diversity issues can be a bridge to confronting concerns with gender equity in the workforce.

Beyond matters of improved governance, some studies and reports correlate improved financial performance with greater gender and racial diversity on the board. They reflect a perspective that corporate leadership teams and shareholders value benefit from broad, deep perspectives and backgrounds. While there remains some debate on this point, there is increasing consensus that corporate decision making and talent acquisition are likely to improve within a corporate culture that supports diversity in backgrounds and perspectives.

As the CEO of asset manager BlackRock has stated, "Boards with a diverse mix of genders, ethnicities, career experiences, and ways of thinking have, as a result, a more diverse and aware mindset. They are less likely to succumb to groupthink or miss new threats to a company's business model. And they are better able to identify opportunities that promote long-term growth."

## Timing Counts

Public discourse on board diversity has been re-energized by the enactment of the new California law, and by renewed pressure from asset managers and institutional asset owners. *The Wall Street Journal* reports that boards are using vacancies to add women and other diverse members. Indeed, new studies show that only one company is left in the S&P 500 with an all-male board. In that regard, a new Spencer Stuart study also links lower board turnover rates in



the S&P 500 with lower opportunities to increase diversity.<sup>1</sup>

For these and other reasons, hospitals and health systems that have failed to take meaningful steps towards incorporating diversity considerations into the director nomination process risk reputational harm and other critical response. They will be true “outliers.”

### **But as to Non-Profits?**

It may be true that much of the movement on diversity has arisen from the public sector, and from best practices compilations traditionally associated with the public company sector. But that’s not to suggest that these themes of board diversity don’t apply equally to large non-profit organizations, including hospitals and health systems. The perceived governance benefits from

a broadly diverse board are not limited to form of corporate status or industry sector. The public company orientation of some of the policy discussion is no excuse for precluding full board consideration of diversity issues.<sup>2</sup>

### **An Important Bridge**

Increased board focus on governance diversity also provides an important bridge to its consideration of broader workforce culture matters. Of particular relevance in this regard is “gender equity” and board support for the promotion of women within the organization. A well-publicized component of this is the “onliness” factor; i.e., where there is only one or possibly two women “in the room” (or in the boardroom, as if the women members of the board reflected a board-determined quota).

### **Conclusion**

Hospital and health system leadership is well-advised to ensure that the board’s nominating committee is aggressively incorporating matters of diversity, across the spectrum, in its identification of potential directors and committee members. The failure to do so could expose the organization and the board to significant criticism and could actually serve to limit the effectiveness of the board due to its failure to incorporate diverse perspectives in its membership. ●

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1 2018 United States Spencer Stuart Board Index (available at <http://bit.ly/2DR3txd>).

2 For more information on strategies and tactics for increasing diversity on hospital and health system boards, see *Building a More Diverse Board, A Toolbook for Healthcare Boards and Executives*, The Governance Institute, Fall 2018.