Part III:
Initiatives to Promote Diversity and Reduce Systemic Bias in Corporate America: Boards of Directors

Diversity at the board of directors level, particularly in terms of Black directors, continues to lag. As of 2020, among Fortune 500 companies, only 9% of board members were Black men or women.[1] In 2019, of S&P 500 companies, 37% lacked a single Black director.[2] The Center for Talent Innovation has found that Black people hold only 3.2% of leadership roles at large U.S. companies,[3] and only four Black individuals are currently Fortune 500 CEOs.[4] Steps that can have a meaningful impact on Black membership on boards of directors—by changing the selection process and promoting growth and development of selected Black directors—include:

- **Broadening the candidate pool and expected qualifications for directors**. Historically, companies have often recruited directors from a relatively small pool of C-suite level personnel, such as CEOs and COOs, from other major companies. Common criteria often include prior experience on other corporate boards, which can act as a self-reinforcing restriction on increasing diversity. Altering the expected (or required) background and professional experience for directors can also remove an impediment to increasing diversity and the pool of potential Black directors. Changes to the selection criteria used to identify potential directors can also make a significant difference in increasing Black representation.

- **Utilize different methods to identify potential director candidates.** Companies often rely on personal connections and networks of their executives to identify potential board candidates, which can limit the number of Black candidates. Retaining an executive search firm and providing clear guidelines can help broaden the candidate pool and move the search away from one driven by personal relationships. Looking to non-profit boards for potential candidates can also help companies identify more Black candidates.

- **Undertaking measures to promote and support Black board members.** The work does not stop for companies even after they have increased the number of Black directors. Companies must then work to ensure the existence of an egalitarian culture in which the CEO, Chairman, or lead director help to create a more open communication environment that will better take advantage of board diversity. In addition to the benefits inherent in increased diversity, taking these steps can also increase the development and satisfaction of Black directors. Boards that value open communication may also be more likely to engage in conversations about diversity.

Benefits of a Diverse and Inclusive Board

Increasing diversity, both among the broader workforce and at the higher levels of boards of directors, has become an increasing focus of companies in recent years. This push is supported by research showing tangible benefits to increased diversity, as well as increased risks that companies face relating to a lack of diversity.

Studies have shown that a diverse and inclusive board can lead to both tangible and intangible benefits for companies. A 2020 McKinsey report found that in 2019, top-quartile companies in terms of racial diversity at the executive level outperformed those in the bottom quartile by 36 percent in profitability.[5] McKinsey's analysis of prior years showed similar correlations between racial diversity and profitability, with top quartile to bottom quartile improvement of 33 percent in 2017 and 35 percent in 2014. The McKinsey study also found that these increases in profitability were significantly higher than comparisons between the top quartile and bottom quartile in terms of gender diversity, where increases in profitability were 15 percent in 2014, 21 percent in 2017, and 25 percent in 2019.

Surveys of directors also show a universal recognition of the benefits that come with increased diversity on boards. More than nine in ten directors agree that board diversity brings unique perspectives to the boardroom, according to PwC's 2019 Annual Corporate Directors Survey.[6] Similarly, 87 percent of directors surveyed by PwC in 2019 said board diversity enhances board performance and 76 percent said it enhances company performance.

In addition to the multitude of benefits that can accrue from a racially diverse board, a lack of diversity on boards is also beginning to present *risks* to companies. Perhaps most importantly, in recent years major institutional investors have attempted to leverage their significant influence to incentivize companies to take tangible steps to increase board (as well as executive and employee) diversity. In March 2017, for example, State Street Global Advisors announced that it would start voting against board members tasked with nominating new board members if progress is not made to improve female diversity on the board.[7] CalPERS, another large institutional investor, sent letters in 2017 to more than 500 US companies in the Russell 3000 index regarding lack of board diversity[8] and reported that through May 2018 it withheld votes or voted against 271 directors at 85 companies as a result of board diversity concerns. Finally, in February 2018, Blackrock announced that it was prepared to vote against director nominees when boards fail to make progress on improving diversity.[9]

Other steps taken by institutional investors have highlighted the importance of increasing racial diversity at the board level. State Street Global Advisors, for example, has integrated Sustainability Accounting Standards Board diversity metrics into its Environmental, Social and Governance scoring system. In August 2020, State Street Global Advisors followed up earlier initiatives targeting increased racial diversity by expanding its expectations for companies.[10] Specifically, State Street asked U.S. companies in its portfolio to provide specific communications to shareholders in five key areas, one of which called for companies to "[a]rticulate goals and strategy related to racial and ethnic representation at the board level, including how the board reflects the diversity of the company's workforce, community, customers and other key stakeholders."[11]

States have also started passing laws that mandate certain publicly-held companies to have diverse boards of directors. For example, in September 2018, California enacted a law requiring publicly-held corporations based in the state to have at least one female director by the end of 2019. And in September 2020, California enacted a law requiring publicly-held companies based in the state to include board members from historically underrepresented groups. This law will require one board member from historically underrepresented groups in 2021, with the requirement expanding to as many as three members from historically underrepresented groups (depending on the size of the board) starting in 2022. Other states have also considered or passed similar legislation in recent years. For example, in March 2019, the Illinois House passed a bill which would have required Illinois-based publicly-listed corporations to have at least one female director *and* at least one Black director. Although these provisions did not make it into the final law, these two efforts point to a trend of states taking more concrete steps to mandate increased board diversity.

Finally, a lack of board of diversity is potentially turning into a source of legal risk for companies in the form of shareholder derivative lawsuits. Several recent complaints filed against major corporations illustrate this potential risk.

In July 2020, a shareholder of Oracle Corporation filed a derivative suit alleging that Oracle's failure to appoint racially diverse directors and officers while making public statements avowing a commitment to racial diversity constituted securities fraud. The complaint contains allegations that Oracle's directors "deceived stockholders and the market by repeatedly making false assertions about [Oracle's] commitment to diversity. In doing so, the Directors have breached their duty of candor and have also violated the federal proxy laws." According to the complaint, as of the date of the complaint, "Oracle's Board today in 2020 has no African-Americans and no Latinos; and no Asian-American or other minority representatives aside from [one director]." In summarizing the theme of the complaint, plaintiffs opined that "[p]latitudes in proxy statements are not progress. Simply put, Oracle has no *real* commitment to diversity and its Board is turning a blind eye to the Company's miserable failure to ensure the 'diversity' trumpeted by the Directors in Oracle's filings with the Securities and Exchange Commission ("SEC") and its annual reports to shareholders."

Since the filing of the shareholder derivative lawsuit against Oracle, similar suits have been filed against Facebook, Qualcomm, NortonLifeLock, and The Gap. Rather than seeking damages to plaintiffs, as is often in the case, these recent shareholder derivative lawsuits have requested specific changes to corporate personnel or practices. For instance, the derivative suit filed against Qualcomm requested the following relief:

- Qualcomm should fire its Chief Diversity Officer and replace her with an African American;

- Qualcomm should replace three of its directors with two African Americans and one other diverse member;

- Qualcomm should create an $800 million fund to hire Black professionals and other diverse member and promote them to management positions at the company;

- Qualcomm should publish an annual Diversity Report with median pay data and should require annual training of its Board regarding diversity and anti-discrimination topics; and

- Qualcomm should replace PwC (which plaintiff alleges failed to hold the company accountable for its diversity initiatives and related internal controls) as its auditor.

As these derivative suits are novel in their legal theory it is difficult to predict whether courts will end up providing the relief requested by the plaintiffs. Regardless, companies facing such lawsuits may find it more sensible to undertake certain initiatives and steps independently, whether to render potential lawsuits moot or because they align with the company's diversity goals.

Recruiting a Diverse and Inclusive Board

In general, companies should carefully consider what they are looking for in their directors; the search and hiring process that they undertake; and the consequences of rules on director age caps and tenure limits. Companies should avoid reflexively filling open board seats with people already in the personal and professional networks of existing directors, and instead broaden the range of professional backgrounds considered for board member positions, which will allow room for more social and professional diversity.[12]

Broadening the Candidate Pool and Selection Criteria for Potential Board Candidates.

As a critical first step, companies can **broaden the candidate pool from which they select their directors**. Historically, companies have often recruited directors from a relatively small pool of C-suite level personnel, such as CEOs, CFOs, and COOs, from other major companies. Executives at major companies have historically lacked diversity due to a number of factors, which in turn has also limited diversity at the board level. As such, companies should consider recruiting from outside of this pool (and especially the CEO, CFO, and COO pool) to increase Black representation on boards and foster boards that have more diverse experiences and views.

Broadening the range of professional backgrounds and experience considered for board member positions is another step that companies can take to attract more Black directors. Indeed, Spencer Stuart's 2019 board survey found that new diverse directors in 2019 had a wider variety of professional experiences than non-diverse directors. Specifically, 18% of the diverse directors selected in 2019 by S&P 500 companies had professional experiences falling into categories not typically associated with corporate board members, such as academics, non-profit, consultants, and government or military service, compared to just 7% of the non-diverse directors.[13] Altering the expected (or required) background and professional experience for directors can remove an impediment to increasing diversity and the pool of potential Black directors.

In a similar vein, companies can **reassess their goals for the board and alter their selection criteria** in a way that will help accomplish these goals. For example, common criteria often include prior experience on other corporate boards, which can act as a self-reinforcing restriction on increasing diversity. Spencer Stuart's 2019 Board Index found that only 19% of the diverse directors appointed in 2019 were current or former CEOs, compared to 44% of non-diverse men.[14] This statistic shows how growth of Black directors would be inhibited by a continued restriction of the candidate pool to former CEOs. Similarly, 34% of the diverse directors appointed in 2019 were first-time corporate directors, which was nearly double the 18% of the non-diverse directors.[15]

Tangible Steps to Help Identify Black Director Candidates.

Companies can take several tangible steps to help identify Black director candidates. In an effort to identify a broader candidate pool that includes more Black candidates, companies can **partner with executive talent pipelines** to identify highly qualified, board-ready Black executives. As noted above, the Corporate Board Initiative, the Executive Leadership Council, the Black Corporate Directors, and the African American Directors Forum are organizations poised to aid organizations in identifying highly qualified, diverse board-ready executives. Entering into relationships with these types of organizations can increase the likelihood that companies diversify their boards of directors.

Utilizing an executive search firm, rather than relying on a selection process that is likely to be driven by the networks and preferences of current board members and executives, can help increase the likelihood that Black directors are identified, nominated, and elected. Corporate board member searches often are based on relationships and do not involve retention of a search firm.[16] Perhaps unsurprisingly, as noted above, the relationships of current directors will often fall largely within the circle of current executives and directors, which is often a less diverse group than the wider population of qualified candidates. Engaging search firms more frequently may result in more qualified and diverse candidates being selected, rather than those with established relationships with existing board members. This will particularly be the case if companies provide direction and instructions to the executive search firm that make clear that diversity, both in terms of background and professional experiences, should be among the primary factors considered in the search.

There are some indications that companies are beginning to expand their candidate pool in this way, with benefits for both racial diversity and diversity in professional backgrounds more generally. For instance, Spencer Stuart's 2019 Board Index report found that in several respects, the new directors selected in 2019 by S&P 500 companies generally came from beyond the traditional pool of CEOs and existing boards of directors. Specifically:

- 65% of the 2019 class of new directors come from outside the top executive positions of CEO, chair/vice chair, president and COO;
- 27% of the 2019 class of new directors had no previous experience serving as a director for a public company.[17]

Finally, companies can make efforts to **recruit more directors from non-profit boards**, which often have a higher percentage of Black directors. The Black Corporate Directors Time Capsule Project, which was conducted by a former Black director to obtain the views and experiences of Black directors at major companies, found that the vast majority had significant experience on non-profit boards prior to obtaining corporate board positions.[18] Companies should focus recruitment efforts on these boards, both to focus on increasing diversity and to obtain directors with experiences that will enable them to excel from their first day on the board.

Measures to Encourage Board Turnover.

In practice, the low turnover rate of boards of directors – particularly those of larger corporations – presents a significant impediment to increased diversity. Several statistics from the 2019 Spencer Stuart Board Index survey highlight this lack of turnover:

- In 2019, 29% of S&P 500 boards were unchanged, which dramatically reduces the number of open seats for which Black candidates could be selected.
- Of the S&P 500 directors that departed their posts in 2019, the average age was 68.7 years old, with 60% over 70 years old. The average tenure of these departing directors was 12.3 years.

In certain respects, companies seem to have regressed in terms of formulating board policies that encourage more turnover (and therefore more seats available to new candidates who may be diverse, whether racially or in terms of gender). In 2019, 46% of S&P 500 boards with a retirement age set it at 75 or older, whereas in 2009 only 15% of such companies set the mandatory retirement age at 75 or older. This allows directors to serve on boards for very long terms, thereby reducing turnover.

Research shows that lowering the age cap on directors could serve as a powerful tool to induce more turnover and create opportunities to fill empty seats with Black candidates. In 2019, for example, more than three-quarters of the independent directors who departed S&P 500 boards in 2019 served on boards that have a mandatory retirement age, and of those, 55% of departures were of directors who either met or exceeded the age cap or were within three years of the cap. Alternatively, companies can consider shortening the maximum terms of directors to incentivize more turnover. This latter approach may be more palatable for companies, as it is does not target any specific age cohort but instead is designed to ensure more frequent turnover of board members.

Make Firm Commitments and Pledges.

Companies should join initiatives and make firm commitments to adding more Black directors. For instance, in August 2020, a number of companies, including Zillow and Nextdoor, joined the Board Challenge, pursuant to which the companies pledged to add a Black director within the next twelve months.[19] Public commitments to these types of initiatives make it more likely that companies will actually take action to further diversity goals and should be strongly encouraged.

Diversity Advisory Boards

For foreign companies with a large presence in the U.S. that do not have U.S.-based boards, a Diversity Advisory Board can play an important role in fostering a diverse and inclusive company culture. An external Diversity Advisory Board can strengthen a company's diversity and inclusion efforts by meeting regularly with senior management and providing guidance on the implementation and development of the company's diversity strategy. For example, Toyota's Diversity Advisory Board, which was created in 2002, is charged with working with senior leadership to help ensure executive accountability and drive adoption of best practices.[20] U.S.-based companies have also created similar external advisory entities. Comcast Corporation created an external Diversity Advisory Council in 2011 to advise the senior executive teams on areas including corporate governance, employment/workforce recruitment & retention, procurement, programming, and philanthropy & community investment.[21]

Promoting a Diverse and Inclusive Board

The work does not stop for companies even after they have increased the number of Black directors. Companies must then work to ensure the existence of an egalitarian culture in which the CEO, Board Chair, or lead director help to create a more open communication environment that will better take advantage of board diversity. In addition to the benefits inherent in increased diversity, taking these steps can also increase the development and satisfaction of Black directors. Boards that value open communication may also be more likely to engage in conversations about diversity.

As a critical first step, companies can increase accountability and transparency around board diversity by **tracking and analyzing data** on the diversity of their board of directors over time, comparing the data to organizations of a similar size and in a similar industry, and sharing the data with key stakeholders.[22] Collecting and analyzing this data on the number of Black directors is a foundational step for other diversity initiatives, but not the end of the road. Indeed, a company's board of directors is generally publicly available information that can be readily obtained by the public and employees. Nonetheless, clear steps by companies to track these metrics and regularly develop concrete plans to address any shortcomings can increase the likelihood that goals of diversifying boards of directors are actually achieved.

Building off the tracking of diversity metrics, companies can encourage board members to take ownership in the process of promoting diversity and to hold leadership accountable by **tying compensation to diversity and inclusion efforts**. Compensation is an important tool through which companies mold incentives and can therefore be used to reinforce diversity values. By tying diversity and inclusion efforts to performance evaluations and compensation, companies will be treating diversity and inclusion as a business imperative and providing executives with a financial incentive to become invested in diversity and inclusion initiatives.[23] As the corporate body that typically sets executive compensation, Board members are in a unique position to have a powerful impact in setting a tone from the top by including diversity objectives in executive compensation.

Furthermore, the design and implementation of these programs will likely play a significant role in their success. For example, factors that may affect whether a plan sparks improvement in diversity may include how heavily this measure is weighted in a compensation or bonus program and how difficult the diversity-related goals are to achieve.[24] For instance, if bonus compensation is tied to a broad portfolio of strategic performance goals, one of which is a diversity initiative, executives may be able to obtain the bonus while focusing on other factors which are taken into account, with no progress being made on diversity efforts. Additionally, directors who seek to push for these types of compensation schemes should expect to receive resistance from at least some of their fellow board members, as only 39 percent of directors surveyed by PwC in 2019 said that diversity objectives should be included in their company's executive compensation plans.[25]

Once companies have a board of directors that includes Black and other diverse directors, they should take steps to ensure that these directors are well-integrated into the board. Long-term retention of Black and other diverse directors is critical to maintaining and continuing to develop diversity on boards. All board members should be given responsibility for and play a role in diversity and inclusion initiatives. For instance, on equity issues such as resolving pay disparities or ensuring a safe workplace environment, the board should involve a diverse group of leaders, rather than simply relying on Black and other diverse directors to handle these issues.[26] Relying solely on Black directors to handle issues relating to racial equity initiatives could have several negative effects. *First*, relying on a small group of directors to handle equity issues can create a perception that there is not full buy-in from the entire board. *Second*, relying on a small group to handle equity issues can create a perception that this group speaks for the entire board. Instead, key equity issues should be handled by the entire board and should be communicated accordingly. *Finally*, relying on Black or other diverse directors to handle all equity issues can harm the morale of these directors and create a perception that they were primarily brought onto the board to handle these issues, rather than other significant corporate issues that the board typically handles.

Companies should also undertake clear efforts to ensure that **Black directors are able to obtain leadership positions on corporate boards**. According to a recent Harvard Business Review study, despite often having stronger academic qualifications and similar levels of experience on corporate boards, Black directors are less likely to hold leadership positions on corporate boards.[27] The study found that only 25 percent of Black directors were board chairs or lead directors, compared to 37 percent of White directors. Furthermore, only 42 percent were committee chairs (including the nominating committee, which controls board nominations) compared to 52 percent of White directors. Ensuring that Black directors frequently chair the nominating committee in particular can help ensure that companies actually consider and nominate more Black directors. And ensuring that Black directors are able to obtain leadership positions on corporate boards will increase longer-term retention of these directors.

On a related note, companies should take clear steps to **provide opportunities to new Black directors for mentoring and developing relationships with corporate leaders**. The Black Corporate Directors Time Capsule Project, which was conducted by a former Black director to obtain the views and experiences of Black directors at major companies, found that one of the primary indicators of success for Black directors is a strong relationship with the CEO, along with strong relationships with other board members.[28] Companies should therefore help foster the development of these relationships to enable Black directors to succeed.

Similarly, to create conditions that will enable Black directors to thrive, companies should provide clear support for existing Black corporate board members in their diversity efforts (including in procurement and philanthropy).

Another measure that companies can take to help ensure that Black directors are able to excel in their directorships is to **encourage and assist Black board members in obtaining concurrent non-profit board positions.** The Black Corporate Directors Time Capsule Project discussed above found that many Black directors viewed service on non-profit boards as providing invaluable training and experience that helped them prepare for and excel on corporate boards.[29] To achieve this goal, companies can incentivize *all* board members to also serve on non-profit boards (and to assist each other in obtaining these types of directorships).

Endnotes

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