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Business Ethics and Board Diversity

Introduction

Equality and non-discrimination in the workplace are important ethical issues for companies as well as being required by UK law. Women make up just over half the workforce in the UK and yet they are underrepresented in senior management and, in particular, in boardrooms. This issue has achieved recent prominence with the mention of boardroom diversity in the new 2010 UK Corporate Governance Code(1) and the publication in February 2011 of a government commissioned review by Lord Davies of Abersoch into women on UK boards(2). Companies that are serious about corporate governance and business ethics are turning their attention to gender diversity at the most senior levels of business.

Business Ethics and Diversity

The Equality and Human Rights Commission defines diversity as "where many different types of people are included". Workplace diversity relates to age, disability, gender, race, religion and belief, sexual orientation and other 'protected characteristics' identified in the UK Equality Act 2010(3). Significantly, it also includes differences in areas such as values, thinking and viewpoints, socio-economic background, experience and knowledge.

Companies that are committed to diversity are making an ethical undertaking to recruit and treat employees fairly and without discrimination. Diversity in the boardroom sets a leadership example and sends a powerful signal to all employees about the company's approach to equal opportunities.

In addition, the reference to board diversity in the UK Corporate Governance Code demonstrates that diversity is one element of good corporate governance. Good corporate governance is an essential foundation for achieving a strong ethics culture within an organisation. According to Matthew Fell, Director of Competitive Markets for the Confederation of British Industry (CBI), "The key to good corporate governance is to have balanced boards, made up of people equipped with the right skills and who operate within a culture of challenge"(4).

Current Situation

Women are underrepresented in corporate boards worldwide. The new UK Corporate Governance Code attempts to remedy the UK situation. It states that: "The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender" (p13, opcit).

(1) Financial Reporting Council, *UK Corporate Governance Code 2010*. Available at: http://www.frc.org.uk/corporate/ukcgcode.cfm

(2) *Women on Boards*, Lord Davies' independent review, 2011. Available at: http://www.bis.gov.uk/assets/biscore/business-law/docs/w/11-745-women-on-boards.pdf

(3) See: http://www.homeoffice.gov.uk/equalities/equality-act/

(4) *The Eversheds Board Report: Measuring the impact of board composition on company performance*, Eversheds, 2011. See: https://www.eversheds.com/uk/home/articles/index1.page?ArticleID=templatedata\Eversheds\articles\data\en\Financial_institutions\Eversheds_Board_Report_080711

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Recent figures published by Cranfield School of Management show that in the UK only 13.9% of FTSE 100 board members are women (and only 8.7% of the FTSE 250(5)) - encouragingly this is up on the 12.5% figure for the past three years. Around one fifth of FTSE 100 boards and over half of FTSE 250 boards have no women board members at all. In the USA the percentage of women on top corporate boards has remained at 15% for the past five years(6).

Lord Davies' *Women on Boards* review recommended that companies in the FTSE 100 should aim for a minimum of 25% female board member representation by 2015. He also called on Chairs of listed companies to announce aspirational gender diversity goals by September 2011 to ensure that the number of female board members is increased.

The CBI has warned that listed companies must convince the EU that they are doing all they can to increase the number of women board members voluntarily or they will face quotas. The CBI favours a 'comply or explain' approach rather than imposed quotas(7). This is reflected in further proposed changes to the UK Corporate Governance Code requiring listed companies to publish their policy on boardroom gender diversity and report against it annually(8).

Around the world, Norway has the highest proportion of women board members due to a legal requirement for there to be 40% women on the boards of publicly listed companies since 2008. France, Spain and Iceland have also passed legislation requiring quotas while other countries such as Australia have a 'comply or explain' approach.

The Case for Board Diversity

Supporters of diversity point out that having a range of viewpoints and perspectives helps to avoid 'groupthink' and is bound to put a company in a better position for understanding the risks and opportunities that it faces. They also argue that a diverse workforce encourages innovation, helps to meet the needs of different customer or stakeholder groups and allows companies to tap into a wider range of talented employees.

There is evidence that gender diversity makes sound financial and management sense for companies:

- The first of a series of reports by McKinsey & Company entitled *Women Matter* found that companies with three or more women in senior management positions scored more highly against critical measures of organisational excellence than companies with no women at the top. These companies also had better financial performance(9).
- A 2011 report by international law firm Eversheds found that better performing companies tended to have a higher percentage of female directors and that this was particularly the case in the UK(10).
- A survey of Fortune 500 companies in 2007 showed that those in the top quartile for women's representation on their boards outperform those in the lowest quartile by at least 53 per cent on returns on equity. Challenges remain, however, since only 28 per cent of business leaders said that women's advancement was a top10 priority for senior leadership(11).

Gender diversity also makes a difference in the boardroom in terms of leadership approach and priorities. The US report *Critical Mass on Corporate Boards*(12) identifies that women have a more "collaborative leadership style" and "bring new issues and perspectives to the table, broadening the content of boardroom discussions to include the perspectives

(5) Figures supplied by Cranfield School of Management

(6) *The Female FTSE Board Report 2010: Opening up the appointment process*, International Centre for Women's Leadership, Cranfield University School of Management, 2010. See: http://www.som.cranfield.ac.uk/som/ftse

(7) CBI press release, 5 May 2011. See: www.cbi.org.uk/ndbs/press.nsf

(8) The recommended changes have been proposed in the document *Gender Diversity on Boards*. For more information see: http://www.frc.org.uk/corporate/ukcgcode.cfm

(9) *Women Matter: Gender diversity, a corporate performance driver*, McKinsey & Company, 2007. Available at: http://www.europeanpwn.net/files/mckinsey_2007_gender_matters.pdf

(10) *The Eversheds Board Report: Measuring the impact of board composition on company performance*, Eversheds, 2011. Opcit.

(11) *The Bottom Line: Corporate Performance and Women's Representation on Corporate Boards*, L Joy, NM Carter, HM Wagner, and S Narayanan, Catalyst, 2007

(12) *Critical Mass on Corporate Boards: Why three or more women enhance governance*, VW Kramer, AM Konrad and S Erkut, 2006

of multiple stakeholders." The report states that "many of our informants believe that women are more likely than men to ask tough questions and demand direct and detailed answers."

These findings are echoed in other research. Another US study found that female directors have better committee attendance records than men, are more likely to join monitoring committees and "appear to be tougher monitors than their male counterparts"(13).

A third US survey found that 90% of female directors and 56% of male directors thought that "women bring special attributes to a board". Men were significantly less likely than women to think that having three or more women on a board would make it more effective. The female directors interviewed for the survey were harsher critics of their own company's board and supported greater oversight, prompting the report authors to suggest that more women in the boardroom "will likely usher in a new era of governance"(14).

A Swedish survey found that male and female company directors "are significantly different in terms of values'" and suggested that "'more gender diverse boards may embrace stakeholder interests to a greater extent"(15). Interestingly, both the *Critical Mass* report and the McKinsey research find that differences are only noticeable in companies with a 'critical mass' of three or more women at senior management or board level.

Research by the IBE which surveyed 791 British full time employees in 2008, found that female employees are generally stricter in their ethical standards; for seven of ten workplace behaviour practices, women were more likely to consider them unacceptable than men(16). The survey also suggested that women are much more likely to report misconduct than their male peers(17) and that women and older employees are less likely to be tolerant of unethical workplace practices than male and young employees. This is indicative that female and older managers can act as role models for ethical leadership.

As well as a business case for diversity, studies have explored its effect on 'social performance' and reputation(18). For example, women directors have been found to have more diverse expertise than men and this enhances the board's ability to effectively address corporate responsibility (CR). Also, the number of women on a board may act as a signal to observers that the firm pays attention to diversity and is therefore more socially responsible. Fortune 500 companies with a higher percentage of female directors were more likely to appear on Ethisphere Magazine's 'World's Most Ethical Company' list(19).

"A big part of the reason we want women better represented at leadership levels in business is because they bring a different perspective to the table that could lead to enhanced decision-making, more innovation, and ultimately, higher performing teams. While working across gender would be a key aspect of cultural dexterity, it also applies to working across such dimensions as ethnicity, age, and experience."

(Dennis M Nally, Global Chairman, PwC)

PwC has a Gender Advisory Council providing advice and assistance on the issue of women in the company. See: http://www.pwc.com/gx/en/women-at-pwc/gender-advisory-council.jhtml

Achieving a Diverse Board

According to McKinsey, a majority of male and female business leaders now recognise that gender diversity has a positive impact on financial performance (62% of men at CEO, COO, CFO etc level and 90% of women)(20). In spite of this, the percentage of women in the boardroom is barely increasing.

(13) 'Women in the Boardroom and their Impact on Governance and Performance', RB Adams and D Ferreira, *Journal of Financial Economics*, 2008

(14) *2010 Board of Directors Survey*, Heidrick & Struggles and Women Corporate Directors, 2010: http://tiny.cc/l7czn

(15) *Beyond the Glass Ceiling: Does gender matter?* R Adams and P Funk, UPF Working Paper Series, 2010

(16) The list included practices such as pulling a 'sick day'; using company petrol for personal mileage, taking software home, and posting personal mail from work.

(17) *Employee Views of Ethics at Work: The 2008 National Survey*, IBE 2009. For more information see: http://ibe.org.uk/index.asp?upid=48&msid=8

(18) 'The impact of board diversity and gender on corporate social responsibility and firm reputation', S Bear, N Rahman and C Post, *Journal of Business Ethics*, June 2010

(19) See: http://ethisphere.com/?s=nair

(20) *Women Matter 2010: Women at the top of corporations: making it happen*, McKinsey & Company, 2010. Available at: http://www.mckinsey.com/locations/swiss/news_publications/pdf/women_matter_2010_4.pdf

In his *Women on Boards* report, Lord Davies highlights an Equality and Human Rights Commission statement that it will take over 70 years at the current rate of progress to achieve an equal number of female directors of FTSE100 companies(21). Companies need to recruit significant numbers of female board directors in the coming years to avoid the threat of legislation.

This raises two significant questions: Why are there so few women in boardrooms and how can this situation change?

Lord Davies found that two major issues kept coming up in the consultation for his report. These were:

- A lack of flexibility around work/life balance particularly around maternity leave and young families.
- The perception of a traditional male cultural environment, the 'old boys network' and a lack of networking opportunities for women.

The McKinsey research similarly highlights the two key barriers for women: the burden of juggling work and domestic responsibilities along with the demands of senior management requiring an 'anytime, anywhere' workload.

There is fierce debate about whether setting quotas on the number of women on boards is the best way forward. Norway was the first country to pass legislation introducing quotas and to introduce sanctions for non-compliance after voluntary quotas failed to achieve a sufficient increase in the number of women reaching board positions. Proponents argue that quotas allow competent women to get jobs that they would otherwise automatically be denied and have a significant impact on the 'pipeline' of women being promoted through companies to senior management positions. Opponents claim that quotas cause ill will in the boardroom and promote women who are less qualified or competent than the best male candidates. Lord Davies decided against recommending quotas in the UK but stated that "Government must reserve the right to introduce more prescriptive alternatives if the recommended business-led approach does not achieve significant change"(22).

However, the challenge is not just about getting women represented at board level but about developing a pipeline of female talent. *The 2010 Female FTSE Board Report* found a strong correlation between companies with relatively high proportions of women on executive committees and companies with gender diverse boards.

Although leadership from the top is of critical importance, it is a cultural shift throughout the organisation that is required. Unsurprisingly, the McKinsey research shows that companies that have gender diversity on their strategic agenda have more women in top management positions and implement more diversity measures: "Positive practices stand little chance of developing fully if senior management does not commit to changing the culture of the organisation under the sponsorship of the CEO"(23).

Good Practice

Diversity at a senior level can contribute critically to embedding a strong ethical culture - but even more critical is for a board to ensure that values such as fairness and respect are incorporated throughout the organisation, and specifically within recruitment and promotion practices. In addition to mentoring and talent management, diversity training can help to explain the business case and provide skills to engage in diversity conversations. This will help to build an inclusive culture and promote opportunities for all employees to fulfil their leadership potential, regardless of for example, gender, religion or race.

Suggestions for good corporate practice and effective gender diversity measures are outlined below:

The 30% club

The 30% club(24) is an example of an organisation that is taking an active role in encouraging and supporting business to improve female representation on boards. It is a group of Chairmen and organisations which makes practical recommendations and is engaged in a number of activities to help businesses deal with the strategic barriers to greater female representation in leadership positions, such as how to develop a pipeline of female talent. The 30% club is helping to initiate change in women's representation on boards by:

- Tracking progress towards the 30% target;
- Keeping the issue of board diversity 'in the spotlight' through media coverage and events;

(21) *Sex and Power,* Equality and Human Rights Commission, 2008. See: http://www.equalityhumanrights.com/advice-and-guidance/here-for-business/working-better/sex-and-power/

(22) *Women on Boards*, Lord Davies' independent review, 2011, p2. Opcit.

(23) *Women Matter 2010: Women at the top of corporations: making it happen*, McKinsey & Company, 2010, p16. Opcit.

(24) http://www.30percentclub.org.uk/ See also the wheel diagram which illustrates the 30% club's work in this area.

- Working with groups in the field, including the FTSE Cross-Company Mentoring Programme and executive search firms;
- Providing advice and information for businesses on how to improve board diversity and support women seeking board appointments;
- Encouraging Chairmen to publically show their support for board diversity by joining the club and promoting the 30% target;
- Developing new approaches and initiatives to improve women's representation on boards, such as the London Business School's decision to target 30% women on its 2011 MBA programme.

Women on Boards Report

In the *Women on Boards* report, Lord Davies sets out a series of recommendations for companies, including:

- Set out the percentage of women the company aims to have on its board in 2013 and 2015, aiming for a minimum of 25 percent female representation by 2015;
- Disclose each year the proportion of women on the board, women in senior executive positions and female employees in the whole organisation;
- Establish a policy concerning boardroom diversity including measurable objectives;
- Disclose meaningful information about the company's appointment process and how it addresses diversity including a description of the search and nominations process;
- Periodically advertise non-executive board positions to encourage greater diversity in applications.

The Women Matter Survey

The *Women Matter 2010* survey by McKinsey & Company identifies the four most effective gender diversity measures as:

- Visible monitoring by the CEO and the executive team of the progress in gender diversity programmes;
- Skill-building programmes aimed specifically at women;
- Encouragement or mandates for senior executives to mentor junior women;
- Performance evaluation systems that neutralise the impact of parental leave or flexible work arrangements.

Voluntary Code for Executive Search Firms

In July 2011, a group of executive search firms announced a new voluntary Code of Conduct covering boardroom appointments in response to a recommendation by the Davies Review. The Code encourages headhunters to work with businesses to widen their search criteria and produce a more gender-balanced list of candidates. It sets out seven key principles of best practice to follow, ranging from action when accepting a boardroom brief through to induction and also covers succession planning over the medium term and the setting of diversity goals.

The Voluntary Code is available to view at: http://www.augmentumconsulting.com/uploads/media/Voluntary_Code_of_Conduct_for_Search_Firms.pdf

"The recognition by boards that diversity is a key ethical issue is encouraging. They need to take the necessary measures to achieve diversity and to support the rapid and ongoing changes being made in this area."

Philippa Foster Back OBE
Director, IBE

Further Reading

- *Female FTSE Board Report 2011*, International Centre for Women Leaders, Cranfield School of Management (forthcoming November 2011)
- *Women in the Boardroom: a global perspective,* Deloitte Global Centre for Corporate Governance, Jan 2011. Available at: http://tinyurl.com/3lwr55s
- *Women on Boards: a statistical review,* GovernanceMetrics International, March 2010. See http://tinyurl.com/3b6zjvt
- *Increasing Diversity on Public and Private Sector Boards – Part I: How Diverse are Boards and Why?* Available at: https://dspace.lib.cranfield.ac.uk/bitstream/1826/5268/1/299150_GEO_RSF_Cranfield_acc3.pdf

  Part II: What is Being Done to Improve Diversity on Boards and How Effective is This? Available at: https://dspace.lib.cranfield.ac.uk/bitstream/1826/5267/1/299150-2_CranfieldReportPt2_acc.pdf , Government Equalities Office and Cranfield University School of Management, 2009
- *Women's Empowerment Principles*, UN Development Fund for Women (UNIFEM) and UN Global Compact, 2010. See http://www.unglobalcompact.org/Issues/human_rights/equality_means_business.html

THE INSTITUTE OF BUSINESS ETHICS

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> **Emmanuel Lulin, Group Director of Ethics, L'ORÉAL**