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The Financial Reporting Council's Consultation Document: Gender Diversity on Boards

A response by Peninah Thomson

I am the co-founder and director of the *FTSE 100 Cross-company Mentoring Programme*, and the co-author of three books on gender diversity on boards. I welcome this opportunity to comment on the Financial Reporting Council's consultation document.

The consultation document asks for responses to three questions:

1. Are further changes to the Code needed? If so:
2. what should they be; and
3. when should they come into effect?

Questions 1 and 3

My answers to questions 1 and 3 are 'yes' and 'as soon as possible', which means, in effect, for accounting periods beginning on or after June 29, 2011.

More changes are needed, because the Code is a living canon. It must adapt constantly to changes in its environment, and, in respect of gender diversity on boards, its environment has changed significantly since its latest revisions came into effect in June, 2010. The publication of Lord Davies' report in February, 2011 is just one of the developments that have changed the context of the debate. Others include the enactment of statutory quotas or disclosure requirements for women on boards in other countries, summarised in Lord Davies' report, the launch of the European Commission's 'Strategy for Equality between Women and Men 2010 – 2015' in September, 2010, the request to all companies by the EU's Justice Commissioner, Viviane Reding, to pledge to have at least 30% female board members by 2015 and 40% by 2020, and the EU's Green Paper on corporate governance for listed companies published in April, 2011, which asks if listed companies should be required to say whether they have a diversity policy and to report regularly on progress, and/or be required to ensure a better gender balance on their boards.

The inclusion in the June, 2010 revision to the Corporate Governance Code (Supporting Principle B.2) of the stipulation 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" was widely welcomed as a necessary addition, but in view of subsequent changes in the Code's environment, it cannot now be regarded as sufficient.

As for the question of 'when?', there are two reasons why 'as soon as possible' is the appropriate answer. The first is that, by setting targets and deadlines, Lord Davies' report and Commissioner Reding's request have added a new urgency to the issue, that should be reflected as soon as possible in the Code. The second is that, if more gender diverse boards are 'better' boards (whether 'better' is defined in terms of value created or risks reduced), every day the additional gender diversity is delayed is a day of value lost, or avoidable risk incurred.

I recognise that the FRC is not a campaigning institution, and the Code cannot lead in this, or any other area of corporate governance reform. But neither can it afford to be a laggard. As a living canon it must keep pace with the evolution of the conventional wisdom.

Question 2

The first thing that can be said about what changes to the Code are appropriate is that although the inclusion of a reference to gender diversity in B.2 in the current Code was a bold step at the time, it is no longer sufficient. The world has moved on. The issue has moved up the agenda and become more urgent. More must be said.

Lord Davies urged the FRC to amend the code "to require listed companies to establish a policy concerning boardroom diversity, including measurable objectives for implementing the policy, and disclose annually a summary of the policy and progress made in achieving the objectives".

In response to this recommendation, the consultation document suggests the following insertion between the first and second sentences of B.2.4., which prescribes descriptions in the annual report of the work of the nomination committee: "This section should include a description of the board's policy on gender diversity in the boardroom, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives."
This is fine as far as it goes, but it could go further. It could state, for example, that if the board has no policy on gender diversity, it should explain why not, and it could say more about what kind of 'measurable objectives' are appropriate. I have in mind here Dr. Elisabeth Kelan's distinction between 'formative' and 'outcome' variables, and the need to ensure more women match the criteria required for board appointments by either giving women the assignments that lead to board appointments, such as overseas postings, or changing the criteria to accommodate more women. To give effect to these points, the consultation document's suggested addition to B.2.4 could be re-worded as follows:

"This section should include a description of, **or an explanation for the absence of,** the board's policy on gender diversity in the boardroom, **the executive committee and other assignments or appointments known to be predictors of board appointments**, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives."

The consultation document also suggests an addition to section B.6 on board evaluation in the form of an additional ‘supporting principle’:

“Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, the board’s policy on gender diversity, how the board works together as a unit, and other factors relevant to its effectiveness.”

This is an excellent suggestion, but it makes no explicit connection between gender diversity and board effectiveness. I believe there is such a connection, and that it should be explicit in the Code.

Sir David Walker noted, in his review of corporate governance in UK banks and other financial industry entities, published in 2009, that “board behaviour cannot be regulated or managed through organisational structures and controls alone”. Annex 4 of his review pointed to the risks of dysfunctional board behaviour, including “groupthink”, to which some have attributed the excessive lending that led to the 2007-08 banking crisis, and to the dangers of which the FRC refers on page 3 of its consultation document. I share the concern expressed in the consultation document that a low percentage of women directors ‘may weaken the board by encouraging “group think”..’.

Board effectiveness has as much, if not more to do with the behaviour of the board, as with the skills, experience, independence and knowledge of its directors. An evaluation of board effectiveness would, therefore, be incomplete without an assessment of the likely impact on board behaviour of the diversity, or lack of it, of its members.

This could be reflected in the code by re-wording the addition to section B.6 suggested in the consultation document as follows:

“Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, **[deletion]** how the board works together as a unit, **whether a lack of diversity, and particularly gender diversity, may be encouraging ‘group think’ and other dysfunctional behaviour**, and other factors relevant to its effectiveness.”

I recognise that it is not easy to incorporate points such as these, which may be dismissed by some as ‘psychobabble’, in a Code that must remain both neutral and acceptable to the corporate sector as a whole. I believe, however, that the FRC must grasp this nettle, and acknowledge the importance of board behaviour, and the beneficial impact of gender diversity on that behaviour.

Peninah Thomson, 28th July, 2011