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29 July 2011

Consultation Document: Gender Diversity on Boards

Dear Chris,

Thank you for giving the Institute of Directors (IoD) the opportunity to comment on your consultative document, published in May 2011. Issues surrounding corporate governance are of considerable interest to the IoD and its membership. We are therefore pleased to present our views on your proposed changes to the UK Corporate Governance Code.

About the IoD

Founded in 1903, and granted a Royal charter in 1906, the IoD is an independent, non-party political organisation of 40,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 92% of FTSE 100 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies.

Initial remarks

The IoD shares the concerns of the Government and Lord Davies regarding the relatively low numbers of women on the boards of UK listed companies. Although we do not advocate the introduction of compulsory gender quotas, we are actively engaged in supporting – through training, mentoring and professional development - the participation of women in the boardroom and in senior executive roles.

The IoD takes the view that gender diversity can potentially contribute to improved board effectiveness through its impact on the overall diversity of the board. Overall board diversity can, in turn, encourage a board to adopt a more critical and independent approach to decision making. It may also reduce the danger of "groupthink"[1], which is a potential feature of groups sharing similar norms, values and social backgrounds.

One of the key objectives of the IoD's Chartered Director programme is to open up board membership to a broader range of participants. It provides a route by which talented individuals from a wide range of

[1] Groupthink has been defined as "a mode of thinking that people engage in when they are deeply involved in a cohesive ingroup, when the members' strivings for unanimity override their motivation to realistically appraise alternative courses of action" (Janis, 1972).

professional backgrounds can acquire the skills necessary to undertake a board level role. As such, it is particularly relevant to those women (and men) that have not necessarily followed a classic executive career path.

The benefits of board diversity – including gender diversity - were recognised and strengthened by changes to the UK Corporate Governance Code in June 2010[2]. **However, the IoD feels that a further highlighting of gender diversity in the Code would be unjustifiable.**

Gender diversity is only one dimension – albeit an important dimension - of a board's overall diversity profile. As well as gender diversity, diversity in terms of professional background, education, sector experience, nationality, age and personality may all be relevant in the composition of an effective board.

Consequently, although we would welcome greater disclosure of how boards take into account diversity in their nomination procedures – including details of any applicable diversity policies - we believe that such disclosures should relate to diversity in its broader sense rather than to gender diversity alone.

We also wish to caution against a disproportionate emphasis on diversity in the selection of directors. In their study of the role played by "groupthink" in the collapse of Swissair, Hermann and Rammal[3] found that a lack of sectoral expertise on the board was also a key factor that led to a dangerously consensual approach. The Walker Review came to similar conclusions in respect of the boards of major banks prior to the financial crisis[4]. **This suggests that diversity is not enough – directors must also have the right skills and expertise.**

Furthermore, in their review of the psychological literature, Fanto, Soland and Darley[5] observe that diversity can potentially be associated with greater conflict and less productivity. **Diversity is not a panacea for an effective board.** The FRC should also be aware that – contrary to many assertions made in the media and elsewhere - the empirical evidence linking diversity to value creation is far from conclusive[6] [7] [8].

We believe that the focus of the UK Corporate Governance Code should be on "improving the quality and functioning of corporate boards, rather than on any wider social objectives"[9]. An excessive focus on gender diversity increases the risk of a politicisation of the UK Corporate Governance Code. This would be a shame, given the high esteem in which the Code is currently held by the UK business community.

Detailed comments on proposed changes to the Code

1) Should further changes be made to the UK Corporate Governance Code at the current time?

We would support changes to the Code that promote greater disclosure in respect of overall diversity policy. However, from a business perspective, we do not see any pressing need to implement such changes ahead of the next formal review of the Code in 2012.

[2] Supporting Principle B.2: "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". UK Corporate Governance Code, June 2010.
[3] Hermann, A., & Rammal, H. G. (2010*). The Grounding of the "Flying Bank". Management Decision*, 48(7): 1051.
[4] Walker, David (2009). *A Review of Corporate Governance in UK Banks and other Financial Industry Entities*. H.M. Treasury, 26 November 2009.
[5] Fanto, James A., Lawrence M. Solan, and John M. Darley (2011*). Justifying Board Diversity*. North Carolina Law Review, 89: 902.
[6] Ibid: 902.
[7] Nielsen, Sabina et al (2008). *Board Diversity and Firm Performance: An Empirical Investigation of the Mediating Effects of Board Processes and Task Performance*. Academy of Management Proceedings, 14: 474.
[8]Adams, Renée B. and Daniel Ferreira (2009). *Women in the Boardroom and Their Impact on Governance and Performance*, Journal of Financial Economics, 94(2), November 2009.
[9] *Consultation Document: Gender Diversity on Boards*. Financial Reporting Council, May 2011. Page 3.

The UK business community is still adapting to the large number of changes that were made to the Code in June 2010. These changes included new recommendations in respect of boardroom diversity and, specifically, gender diversity (Supporting Principle B.2). The new edition of the Code should now be given an opportunity to stabilise.

In addition, the FRC should seek to avoid piece-meal changes to the Code between formal reviews unless there is an overwhelming business need.

We do not believe that the Code should be used as some kind of political negotiating tool, e.g. to head-off regulatory initiatives on gender quotas from the European Commission or other regulatory bodies. The Code's sole objective should be to identify best practice in corporate governance from the perspective of value creation and UK business competitiveness.

2) Should changes be made to the wording of Provision B.2.4, which concerns the report of the nomination committee? If so, should the following wording be added: "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"?

We are sympathetic to the idea that the board should provide greater disclosure concerning its policies and approaches to boardroom diversity. The report of the nomination committee would be an appropriate place to make such a disclosure.

However, we would not support any new provision on diversity disclosure which relates solely to gender diversity. Any new provision should be about diversity in its broader sense. It should recognise that gender diversity is not the only dimension of diversity that should be considered by the nomination committee. Other types of diversity may sometimes be equally (or more) relevant considerations in a boardroom appointment process.

With that in mind, a more acceptable addition to the wording could be as follows:

"This section should include a description of the board's overall policy on diversity in the boardroom (including but not limited to gender diversity), including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives."

3) Would it be helpful for the FRC to set out some of the key elements to be covered by a gender diversity policy - such as the criteria used when recruiting directors, or the steps taken to develop of senior executive talent - and if so, whether this should be done in the Code or elsewhere?

No, this would not be desirable. Companies and boards – in consultation with shareholders – are better equipped than regulators to determine the nature of a commercially-relevant diversity policy. Such policies must be adapted to the specific circumstances of each organisation. We do not believe that such variations can be effectively anticipated by regulators.

An FRC template for diversity policy would inevitably create pressure to confirm to a "one-size-fits-all" regulatory-driven approach. It would increase the risk that the process is seen as a compliance exercise rather than something that could add value to a business.

4) Should there be a new supporting principle to Principle B.6 (on board evaluation) which sets out the role of board evaluations in monitoring diversity policy? For example: "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."

We do not feel that this new supporting principle would be a helpful addition to the Code. Recommendations in respect of diversity in board composition and appointments have already been made in other sections of the Code. To highlight these issues once again in the context of the board evaluation process would be both repetitive and overly prescriptive.

We believe that board evaluation (including externally-facilitated board evaluation) is an important component of good governance practice. However, opinions differ as to the appropriate content of a board evaluation procedure. Our view is that board evaluation should be mainly concerned with boardroom behaviour rather than matters of compliance with codes, regulations or policies. Other evaluators may favour alternative approaches.

By specifically highlighting the need to monitor gender diversity policy as part of a board evaluation, **the proposed new principle could channel the focus of board evaluations towards compliance monitoring and away from boardroom behaviour.** This would distort the market for board evaluation. The FRC should avoid using the UK Corporate Governance code to prescribe the methodologies of board evaluation reviews.

Thank you once again for inviting the Institute of Directors to participate in this consultation. We hope you find our comments useful.

Yours sincerely,

R. Barker

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