Board decision making and diversity

Where there is real diversity in the boardroom, the directors are better equipped to address the issues presented to them.

BY DOUG RAYMOND

Doug Raymond is a partner in the law firm Drinker Biddle & Reath LLP (www.drinkerbiddle.com).

The duty of care sits at the core of directors' obligations under corporate law. When evaluating a course of action or making a decision, directors have the duty to use that care which "ordinarily careful and prudent persons would use in similar circumstances." This includes the obligation to inform themselves, before acting, of all relevant material information reasonably available to them. In reviewing whether directors have violated their duty of care, courts generally look to the quality of the process by which the board made its decision. As a consequence, thoughtful boards pay attention to how they make decisions and whether they can improve the ways they evaluate information and debate and decide the issues presented to them.

When a board considers how best to optimize its processes for making decisions, it should not take long to conclude that adding meaningful diversity can be a valuable path to pursue. Common sense, as well as an increasing body of academic research, indicates that a diversity of background and opinions will generally foster more creativity and produce a greater range of perspectives and solutions than would otherwise be the case. Where there is real diversity in the boardroom, there is a greater likelihood that the deliberations of the directors will include the evaluation of potential alternatives that either would not occur to a more homogeneous group, or that would be misunderstood or underappreciated and therefore too quickly dismissed. If these varying experiences and points of view are shared collaboratively and respectfully, all of the directors are better equipped to address the issues with which they are presented.

However, even a board with diversity among the directors may not realize the benefits of this diversity unless all of the directors feel free to express their opinions and their views are heard and considered by the other directors. As psychologists and sociologists have demonstrated, if only one person voices a different opinion or perspective, it is less likely to be attended to by the others in the group, and before too long that person will begin to feel constrained. Boards that are committed to improving their decision-making process should structure the boardroom to create an atmosphere where all directors are comfortable challenging their peers and the group is receptive to different perspectives. In most cases, this can be accomplished by greater diversity.

While an all-Caucasian boardroom of greying Ivy Leaguers may conceivably represent a broad diversity of backgrounds and views, it is usually a safe bet that this diversity would be further enhanced by including women and minorities. One metric often used to measure diversity on corporate boards is the percentage representation of women and minorities. In 2014, nearly 30% of new board nominees at S&P 500 companies were women, doubling the figure from 2008. Nonetheless, the number of women holding board seats has not increased at the rate these nomination statistics suggest. As of 2014, about 19% of sitting directors at S&P 500 corporations were women, up about 3% from 2008, even though nominations of women doubled over that same period. When the survey expanded its sample to Russell 3000 companies, women's representation on boards falls to 13%, with approximately 28% of boards entirely lacking any female membership.

Some countries have instituted statutory quota requirements for gender representation on boards (e.g., Germany, Norway, France, Spain, India). While some have called for a similar approach in the United States, it would be a mistake to establish a single criterion for board members at the expense of other significant factors such as experience, integrity and other qualifications. Increasing board diversity, while important, should be viewed by directors in the broader context of evaluating the quality of their decision-making processes.

Over the last 15 years, many changes have occurred in the boardroom with the purpose of improving board governance and the processes boards employ. These changes, some of which have been mandated by the SEC or the stock exchanges, include the nonexecutive chairman (or lead director), holding of executive sessions for only independent directors, full independence of the audit and compensation committees, and independence of a majority of the full board. These changes have been adopted, in large part, to improve the board's decision-making processes, to encourage more candid discussion, and to help ensure that each director has a voice in important discussions, notwithstanding institutional or historic factors that tend to give the CEO the dominant voice. A commitment to a meaningfully diverse board of directors should be seen as the next logical step on this continuum. ■

The author can be contacted at douglas.raymond@dbr.com. Charles Vargo, an associate with Drinker Biddle & Reath, assisted in the preparation of this column.