Enhancing Shareholder Value: A Case for Board Diversity

The civil rights movement of the 1950s and '60s ushered in an era of new employment practices in this country. The Civil Rights Act of 1964 prohibited discrimination based upon race, color, religion, gender, or national origin in hiring and promotion for businesses that had federal contracts or were involved in interstate commerce. This non-discrimination policy was subsequently adopted by state and local government agencies, and it gradually became accepted as sound business practice by corporations nationwide. More importantly, this shift in employment practices opened the door for more women and minorities to acquire the professional work experience necessary to qualify them to serve on company boards of directors.

Wespath Supports Board Diversity

Despite these legislative changes, women and racial/ethnic minorities currently remain under-represented on company boards of directors. According to the Alliance for Board Diversity (ABD), women and minorities accounted for only 26.7% of board seats in Fortune 500 companies in 2012. Wespath withholds support for nominating committee members if the company board is not 20% racial/ethnic/gender diverse and a reasonable explanation for the lack of diversity is not disclosed, according to its proxy voting guidelines.

This 2011 update to its proxy voting position was informed by new legislative requirements and research regarding board diversity, as well as by best practice trends, which indicate that having a diverse racial/ethnic/gender presence on company boards has a positive impact on a company's financial performance. This revision, moreover, better reflects Wespath's commitment to upholding the Social Principles of the United Methodist Church, namely ¶162A, which says, "We further assert the right of members of historically underrepresented racial and ethnic groups to equal opportunities in employment and promotion;" and ¶162F which says, "We affirm the right of women to equal treatment in employment, responsibility, promotion and compensation."

Diversity Transparency Rules

The Securities and Exchange Commission (SEC) implemented new transparency rules—effective February 28, 2010—that require publicly-traded companies to disclose in their proxy voting materials any information regarding board diversity. This Proxy Disclosure Enhancements ruling specifically requires companies to indicate whether they have a board diversity policy. If so, companies must explain what characteristics or attributes are reflected in the policy, how the policy is implemented and how is its effectiveness measured. The SEC does not explicitly define diversity as gender or racial/ethnic identification; however, companies are expected to indicate the particular knowledge, skill set and experience (including background) that made the nominee a qualified candidate for director.

Three years after the implementation of the SECs proxy disclosure amendment, Columbia Law School Student Tamara Smallman found that more than half (60%) of the diversity disclosures among the Fortune 50 fail to fully comply with the rule's requirement. In the Winter 2013 Columbia Business Law Review article "The Glass Boardroom: The SEC's Role in Cracking the Door Open so Women May Enter," Smallman notes that women hold less than a quarter of the board seats of these companies.

Companies that have chosen to comply with the SEC ruling vary in their approach to increasing and quantifying diversity. The McDonald's Corporation, for example, does not adhere to any specific standards for diversity, according to its Notice of 2012 Annual Shareholder's Meeting and Proxy Statement. Yet, more than 50% of McDonald's Board is composed of women and minorities. By comparison, JP Morgan Chase and Co. has two women and one African-American among its 11 director nominees according to its Notice of 2013 Annual Meeting of Shareholders and Proxy Statement.

The Coca-Cola Company may be the best example of how this new SEC disclosure should be implemented. In its Notice of 2013 Annual Meeting of Shareowners and Proxy Statement, the company explicitly stated that there is no policy per se, but "diversity of race, ethnicity, gender, age, cultural background and professional experience [are considered] in evaluating candidates for Board membership." What made the Coca-Cola disclosure particularly noteworthy was the use of a diversity tag line indicating specific attributes (i.e. female, African-American, Hispanic, Swedish national, degree in finance, economics, accounting, and professional experience in government, nonprofit/charitable, global markets, organizations, foreign diplomacy and education).

"We further assert the right of members of historically underrepresented racial and ethnic groups to equal opportunities in employment and promotion."

Diversity's Effect on Company Performance

The SEC ruling may be driving changes in many companies; however, diversity benefits more than just the elected Board member. Board diversity also affects company operations and profitability. A 2013 study—The Advantages of Board Diversity: An Empirical Analysis of the Italian Market—found that board diversity seems to greatly affect the operating performance of the board and contributes to improving the perceived quality of the governance model adopted by the company. Catalyst, a nonprofit organization with a mission to expand opportunities for women and business, also found that board diversity enhances company performance and reputation. They assert in "Why Diversity Matters" that gender diversity on boards is connected with better oversight, less unethical behavior and increased corporate social responsibility. Other studies have echoed these findings, for example:

> The Thomson Reuters study Mining the Metrics of Board Diversity suggests that companies with mixed-gender boards have marginally better or similar performance to a benchmark index (e.g., MSCI World). By contrast, companies with no women on their boards underperformed, on average, relative to gender-diverse boards. They conclude, therefore, that gender equality in the workplace makes good investment and business sense.

In its August 2012 report, Gender Diversity and Corporate Performance, the Research Institute of Credit Suisse found that companies with one or more women on the board delivered higher average returns on equity, better average growth and higher price/book values. They posit that greater board diversity reduces volatility, enhancing stability in corporate performance and in share price returns.

McKinsey Quarterly reported in April 2012 that companies with diverse executive boards enjoy 14% higher earnings and 53% greater returns on equity in the article "Is There a Payoff from Top-Team Diversity?" They, however, are hesitant to suggest causality. Instead, McKinsey offers the results as part of a growing body of best practices.

The 2012 Board of Directors Survey, conducted on behalf of Heidrick & Struggles and WomenCorporateDirectors (WCD) suggests that diversity is increasingly tied to organizational success, a factor which is compelling boards to make diversity a part of their strategic focus. For example, JPMorgan Chase has made increasing diversity a priority. The company's governance committee reviews "available information about the experience, qualifications, attributes and skills of prospects, as well as their gender, race and ethnicity" for all Board prospects. Coca-Cola also prioritizes diversity, saying that a variety of points of view contribute to a more effective decision-making process.

The New Normal: Best Practices in Diversity

According to Calvert Investments, companies with a diverse corporate structure are poised for greater success in today's increasingly complex global market. The Alliance for Board Diversity also believes that diversity at the top can help ensure the sustainability of our businesses and economy. In fact, in "Missing Pieces: Women and Minorities on Fortune 500 Boards," the alliance suggests that unless companies begin to reflect their shareholders, markets and employees, they will fail to reach maximum potential as leaders in the global economy.

While companies report advances in promoting diversity, Earl Graves, Jr., publisher of Black Enterprise Magazine, expresses concern that 30% (75 companies) of the largest 250 corporations do not have a single African-American director. These companies enjoy a tremendous market share from African-Americans, and he believes the leadership should reflect the customer base. Graves encourages board members and shareholders to hold corporate America accountable. To aid in that endeavor, Black Enterprise Magazine's July/August 2013 issue provided a special report, which included a listing of companies with and without African-Americans board members. The special report included observations and insights from several African-American board members about the challenges and rewards of serving in this capacity.

Deloitte LLP—a professional services network, providing audit, tax, consulting, enterprise risk and financial advisory services–advocates for gender diversity in the boardroom, seeing it as an important aspect of good governance and increasingly important in international competitiveness. The company signed the CEO Statement of Support for the United Nations Women's Empowerment Principles. Deloitte also suggests that investors demand gender diversity in the November 2011 report "Women in the boardroom: A global perspective."

As an original signatory to the United Nations Principles for Responsible Investment (PRI) and recipient of various industry awards, Wespath, a division of the General Board of Pension and Health Benefits of The United Methodist Church, supports leading-edge initiatives, and is proud to be a thought leader in promoting board diversity within our investment portfolio. We view attention to board diversity not only as a moral issue, but one with economic implications that bear on our fiduciary responsibility to our plan participants and institutional investors—a responsibility that we take every opportunity to ensure provides optimal returns for our clients and for the Church.

Wespath Chief Investment Officer Dave Zellner (right) shakes hands with UN Secretary-General Kofi Annan (left) after signing the UN Principles for Responsible Investment in April 2006.

Wespath provides UMC-affiliated institutional investors with access to well-managed investment programs that historically have delivered competitive performance while honoring United Methodist Social Principles. Wespath is the investments division of the General Board of Pension and Health Benefits of The United Methodist Church, a century-old institution with a well-regarded reputation for delivering returns aligned with values.

Wespath is an established investment manager with approximately $21 billion in assets under management.

Our name honors John Wesley, the founder of Methodism and a leader in establishing social principles that outline the tenets of socially responsible business practices. Wespath reflects this heritage, along with the idea of putting clients on the right path to financial growth with a commitment to values-driven investing.

Wespath

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