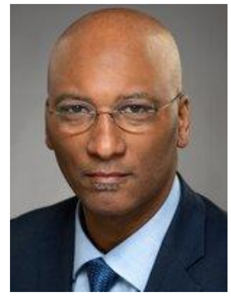
4 Steps For Improving Board Diversity Per New Nasdaq Rule

By **John Lewis, Bill Martucci and Adriana Paris** (September 23, 2021)



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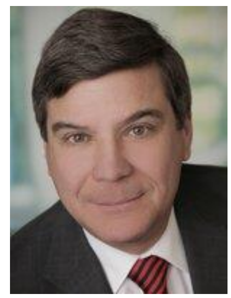

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The U.S. Securities and Exchange Commission has approved Nasdaq's proposal to require every company listed on its U.S. exchange to have at least one director who self identifies as a female and one director who is either an underrepresented minority or LGBTQ+.[1]

If a company cannot meet this diversity requirement, it must provide written explanation as to why. Given that over 3,500 companies are listed on this second-largest stock exchange,[2] this new requirement is expected to shake up the operations of numerous entities in the U.S.

Other board diversity initiatives are also underway. Since 2018, California has required that publicly traded corporations based in the state have at least one woman on their boards of directors. Although that law is currently being challenged,[3] other states are still considering enacting similar laws.[4]

For instance, Illinois enacted a board diversity law in 2019 that requires companies with their principal executive office in the state to not only include female and minority directors on their boards, but also to share their process for nominating and selecting directors.[5] Similar initiatives are also being considered in other states.

This article provides four meaningful steps for ensuring that companies' boards of directors are diverse and reflective of the communities they serve.

1. Assess the board's goals.

While much has been written about directors' duties — such as the duty of care and loyalty — the goals of a board of directors extend beyond simply upholding their legal duties.

With the recent increase in shareholder activism surrounding corporations' environmental, social and governance, or ESG, programs, directors are being asked to define and advance goals such as greenhouse gas emissions reduction, workers' rights, and of course, diversity, equity and inclusion. Thus, increasing shareholder profits is no longer the sole focus of a board of directors in today's society.[6]

Indeed, SEC Commissioner Allison Herren Lee noted in a recent keynote[7] address at the Society for Corporate Governance national conference:

> Our understanding of the significance of ESG and its short-, medium- and long-term relationship to financial performance has evolved to the point that the principal debates are about when, not if, these issues are material.

Given these weighty expectations placed upon boards, now is the time to reassess your board's goals. Aside from the financial performance of the company, what other initiatives and proposals would add value to your company and enhance the impact that directors can have on the culture within your company?

This is where a diverse perspective comes in play. If your criteria for choosing board members include prior board experience, then perhaps consider taking into account a prospective director's lived experience.[8]

What prior projects has this person spearheaded — either at work or during personal time — that can advance your company's goals? What unique life circumstance would add a fresh perspective to your company's purpose?

2. Survey your stakeholders.

A company's stakeholders include a much broader group of individuals than a company's shareholders. Stakeholders can include employees, consumers, vendors and members of the community in which a company operates. By virtue of these different categories, stakeholders can have varying opinions on a company's activities.

While employees may focus on working conditions and expansion of benefits, consumers may care about a company's environmental footprint and transparency surrounding its leadership. Of course, no one corporation can satisfy the competing interests of every stakeholder, but learning what these interests are is the first step.

Social media has given companies the ability to interact with their stakeholders in a way that is more intimate, more targeted and more meaningful than ever before. As Lee observed in her aforementioned keynote address:

> Today, what your business does and says is as likely to be dissected on Twitter and TikTok as it is to be reported in the Wall Street Journal or over a newswire. Consequently, consumers, employees, both current and potential, and a host of others can affect how companies are perceived and how well they succeed.

Some companies today are unfortunately all too familiar with the backlash and the campaigns that unhappy stakeholders are able to rally on social media platforms.

But all is not lost: Truly listening to the diverse voices of your stakeholders and translating the information they share with you into corporate action can make all the difference. Choosing directors that share similar experiences to your stakeholders is key in bridging the gap between corporate goals and the voices outside the boardroom.

This is where companies must expand beyond their traditional board selection criteria and transcend factors such as age, socioeconomic status, prior board experience and educational pedigree.

3. Move beyond quotas.

In attempting to diversify a board of directors, it is critical that companies abstain from mandating diversity quotas.

Not only can candidates sense that they are being used as a token in the interview process, this narrow focus will ultimately fail to achieve the end goal of diverse backgrounds, experiences and opinions on the company's board. Moreover, nominating from underrepresented demographics simply for the sake of diversity can seriously undermine the effectiveness of the board as a whole.

Being mindful of the reasons why a company might seek diverse board membership is not the same as rejecting qualified nominees from underrepresented communities just because that person may change the dynamics on the current board. As Sophia Shaw, professor at Northwestern University's Kellogg School of Management, observed in her research:

> Think of the current board as a Thanksgiving table. Many delicate topics are being avoided to keep the peace. When somebody invites a new member to the table whose traditions or assumptions may be different from the status quo, this can bring to light underlying biases or differences in opinion that have lain under the surface.[9]

To that end, companies must remember that a person can add diversity to a board not only through their identity but also their life experience and prior expertise.[10] The substance of an individual's potential contribution to the board cannot be measured by numbers alone.

4. Play on new board members' strengths.

In both searching for and selecting a director from an underrepresented community, companies should look to that person's experiences, strengths and personal attributes.

While directors from underrepresented communities may have added experience with inclusion and equity initiatives or addressing pay disparities, companies should resist the temptation to pigeonhole these individuals. Taking a holistic view of a new director and what that individual can bring to the table will ensure a mutually beneficial endeavor for the director and the company.

A director from an underrepresented community who has experience with multinational organizations, for instance, could be an invaluable asset for expanding and managing a company's international operations. She could also be an expert in the world of international compliance. While that person could very well spearhead the company's supplier diversity program, she should not be tasked solely with diversity-enhancing initiatives.

To be sure, these four steps do not signal that companies should lower their standards or choose less qualified directors simply to achieve certain diversity metrics. Rather, this is an opportunity for companies to tap into the knowledge and resources of potential board members who may not look like or have the same life experiences as individuals who have historically served on boards.

This evolution in the board nominating process can take companies far beyond their expectations and position them well to address increasing stakeholder pressures.

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[1] "Nasdaq's Board Diversity Rule: What Nasdaq-Listed Companies Should Know," Nasdaq

(last updated August 17, 20201), available at https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf.

[2] See Kat Tretina & John Schmidt, "An Introduction To The Nasdaq Stock Exchange," Forbes (last updated Aug. 12, 2021).

[3] Lydia Beyoud, "California Board Diversity Ruling Emboldens Shareholders," Bloomberg Law (Jun. 23, 2021).

[4] See June D. Bell, "Corporate Board Diversity: Moving Beyond Lip Service," Society for Human Resources Management (Jan. 16, 2021).

[5] Michael Hatcher & Weldon Latham, "States are Leading the Charge to Corporate Boards: Diversify!," Harvard Law School Forum on Corporate Governance (May 12, 2020).

[6] For a discussion on the evolving duties for modern-day boards, see Mary Lipton & William Savitt, "Directors' Duties in an Evolving Risk and Governance Landscape, Harvard Law School Forum on Corporate Governance (Sep. 19, 2019).

[7] "Climate, ESG, and the Board of Directors: 'You Cannot Direct the Wind, But You Can Adjust Your Sails,'" U.S. Securities and Exchange Commission (June 28, 2021), available at https://www.sec.gov/news/speech/lee-climate-esg-board-of-directors.

[8] See Lisa Roper, "What's Keeping Corporate Boards from Becoming More Diverse," (Aug. 27, 2021), available at https://insight.kellogg.northwestern.edu/article/how-to-create-diverse-board-directors-empower-thrive.

[9] Sophia Shaw, "What's Keeping Corporate Boards from Becoming More Diverse," Kellogg School of Management at Northwestern University (Sept. 3, 2019), available at https://insight.kellogg.northwestern.edu/article/how-to-create-diverse-board-directors-empower-thrive.

[10] Simran Jeet Singh, "Boards Need Real Diversity, Not Tokenism," Harvard Business Review (Aug. 31, 2021).