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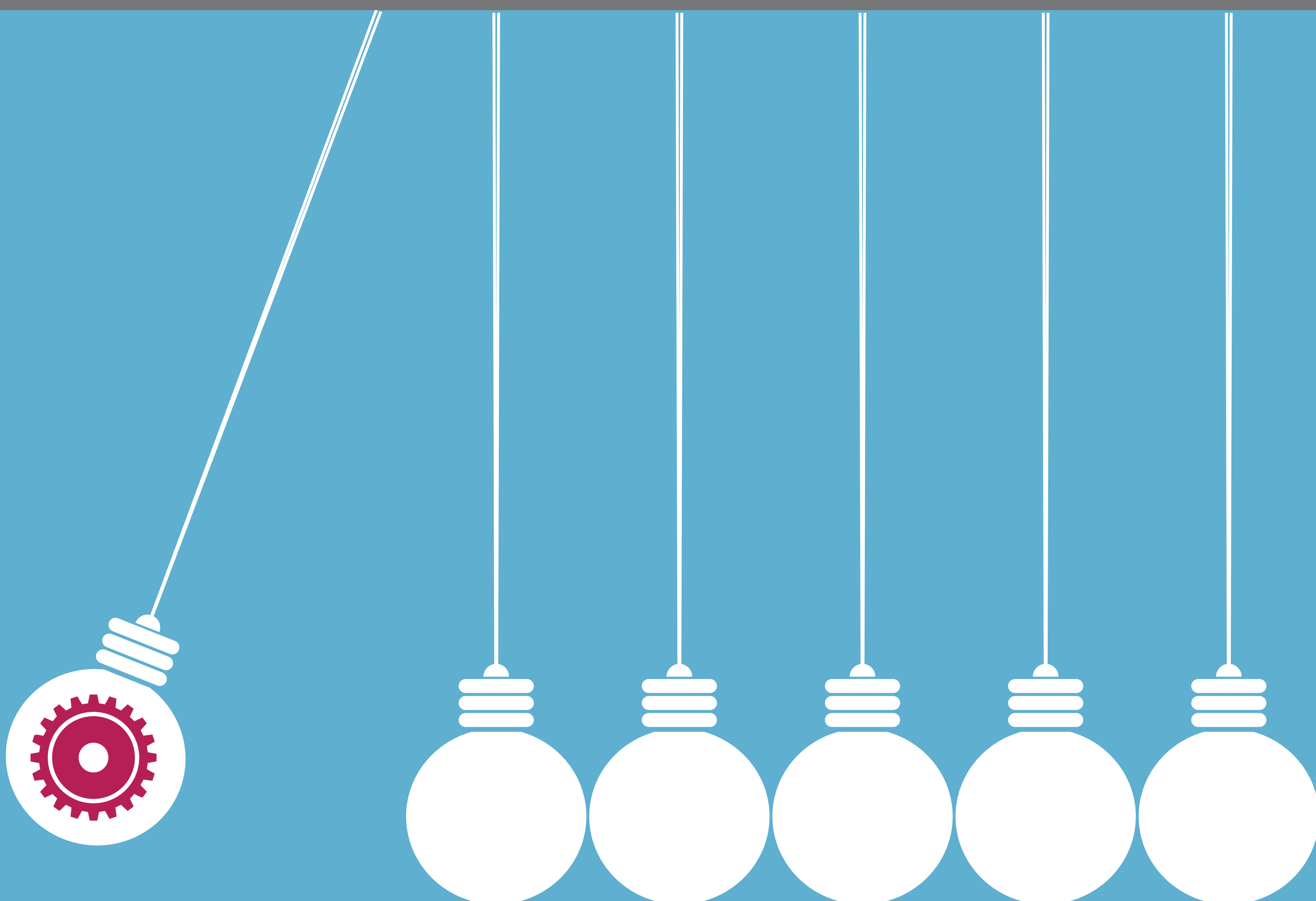
Building an effective and diverse board: Lessons from Asia



As the Asia Pacific region continues to play a growing role in the global economy, regional corporations are increasingly expanding their footprint beyond Asia. To assist with their ambitions for expansion, Asian companies are starting to look for ways to build more diverse leadership teams, boards, and executive committees. Although diversity is crucial to creating more effective boards and improving corporate performance, it must be understood in a much broader sense than is seen in many current boardroom discussions.

Today's regulatory changes are encouraging greater diversity. Hong Kong, Japan, Malaysia, and Singapore, among others, are requiring companies to increase the diversity of their boards—or explain any shortcomings. The aim is for listed companies to consider the benefits of diversity, and examine whether their board consists of a balance of skills, experience, and mind-sets.

Hong Kong	**Corporate Governance Code** • "The board should have a balance of skills, experience, and diversity of perspectives appropriate to the requirements of the issuer's business." • "The nomination committee (or the board) should have a policy concerning diversity of board members, and should disclose this policy (or a summary of the policy) in the corporate governance report." • "Diversity can be achieved through a number of factors, including, but not limited to, gender, age, cultural and educational background, or professional experience." • "Each issuer should disclose the rationale for the factors it uses after taking into account its own business model and specific needs."
Japan	**Corporate Governance Code** • "Companies may consider reporting information about the current status of women's representation on the board."
Malaysia	**Corporate Governance Code** • In June 2011, the Malaysian cabinet approved legislation requiring private-sector companies to have at least a 30% representation of women in decision-making roles. By 2016, women must comprise at least 30% of boards and senior-management roles at public and limited-liability companies with more than 250 employees.
Singapore	**Corporate Governance Code** • Boards "should comprise directors who as a group provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company."

Source: For Hong Kong and Japan, see "Regulatory board diversity," *Increasing Gender Diversity on Boards: Current Index of Formal Approaches*, *Catalyst*, 2014, catalyst.org. For Malaysia, see Loh Foon Foong, "More women now on board," *The Star*, July 26, 2011, thestar.com; and *Gender diversity and corporate performance*, Credit Suisse Research Institute, 2011, credit-suisse.com. For Singapore, see *Code of Corporate Governance*, Singapore Corporate Governance Committee, 2012, mas.gov.sg.

WHAT IS DIVERSITY?

According to Scott Page, professor of complex systems, political science, and economics at the University of Michigan, "diverse groups of people bring to organizations more and different ways of seeing a problem and, thus, faster, better ways of solving it. . . . Any one of us can get stuck. If we're in an organization where everyone thinks in the same way, everyone will get stuck in the same place."[1] The message is clear—if boards are made up of a homogenous group of people, there will be little scope for innovative thinking, which could limit a company's progress and growth.

In their book *Diverse Teams at Work: Capitalizing on the Power of Diversity*, authors Lee Gardenswartz and Anita Rowe present a modification of a helpful tool known as the "diversity wheel," which builds on the work of Marilyn Loden and Judy Rosener.[2] The model shows four levels of diversity (see figure). Most corporate-diversity discussions fixate on the second ring—internal dimensions including gender, race, and other attributes that individuals cannot control. While these aspects are vital for companies to consider, the real power of diversity lies in taking a broader view that balances the internal, external, and organizational dimensions of diversity. When taken together, these can help frame a person's approach to problem solving, as well as other attitudes.

Without a doubt, redirecting focus to a more complete examination of diversity does not negate the importance of factors such as gender, race, and ethnicity, nor does it offer organizations an excuse to neglect these aspects. But when companies focus on such factors exclusively or reflexively, without truly understating why, how, and when diversity creates business benefits, they risk making shortsighted "check the box" decisions that rarely realize the full potential of diversity.

THE UNIQUE DYNAMICS OF ASIAN BOARDS

Family businesses are an integral part of most economies in Asia. In a 2014 report, the consulting firm Ernst & Young (EY) found that 85% of companies in the Asia Pacific region were family-owned businesses and that these companies accounted for 32% of market capitalization in the region.[3] The level of generational experience in governance differs—from Japan, which has some of the world's oldest family-owned businesses, to China, which has some of the youngest.

Diversity can be more difficult to achieve in family-owned businesses because executive power is usually concentrated within a group of relatives, and independent board positions are less common than in companies

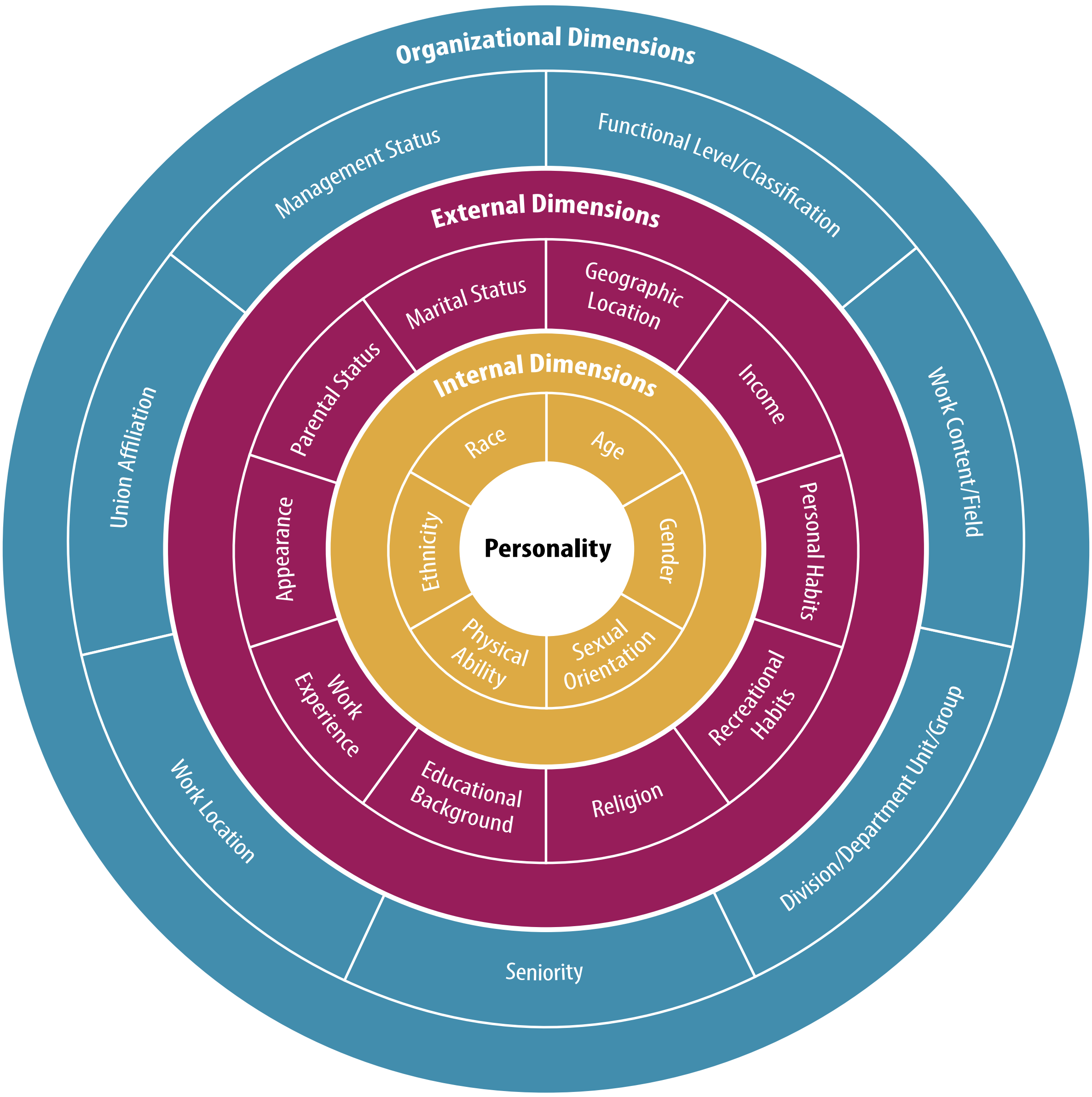
1 Claudia Dreifus, "In professor's model, Diversity = Productivity," *New York Times*, January 8, 2008, nytimes.com. See also Scott E. Page, *The Difference: How the Power of Diversity Creates Better Groups, Firms, Schools, and Societies*, Princeton, NJ: Princeton University Press, 2007.

2 See Lee Gardenswartz and Anita Rowe, *Diverse Teams at Work: Capitalizing on the Power of Diversity*, 1st ed., Irwin Professional Publishing, 1995; and Marilyn Loden and Judy Rosener, *Workforce America! Managing Employee Diversity as a Vital Resource,* Business One Irwin, 1991.

3 See *Family Business Yearbook 2014,* EY, 2014, ey.com.

FIGURE

Companies that expand their understanding of diversity to include organizational and external dimensions can reap the benefits of establishing a more balanced leadership team.



Source: Adapted from Lee Gardenswartz and Anita Rowe, *Diverse Teams at Work: Capitalizing on the Power of Diversity*, Irwin Professional Publishing, 1994; and Marilyn Loden and Judy Rosener, *Workforce America! Managing Employee Diversity as a Vital Resource*, Business One Irwin, 1991 with broader ownership structures. The founders and co-founders often serve in executive positions on the board. In general, these businesses are more reluctant to take on board members from outside their inner circle: when board members or financial controllers who are not relatives resign, families tend to bring in familiar faces, as they are not comfortable inviting strangers or foreigners to help make major decisions about the future of the family business.

A recent increase in mergers and acquisitions by Asian firms implies that many subsidiary boards have likely emerged in these companies. Unfortunately, not many of these parent and subsidiary boards share and align strategies that would help ensure effective and transparent communication. Given the differences in the directors' interests, the board dynamics of these newly merged companies may also become more complex when it comes to board nominations. Therefore many steps need to be taken to enhance board effectiveness before these businesses can consider building diverse boards.

In most studies of workplace diversity, the focus is on gender or other easily quantifiable metrics, although diversity of thinking should be the ultimate objective. Asia typically fares poorly in these measures compared to other regions.

For example, a report by Catalyst, an organization that promotes gender equality in the workplace, found that in 2014, women held only about 3% of board seats in listed companies in Japan, and about 10% in Hong Kong and India, compared to roughly 20% in many other major markets including Australia, Canada, Germany, the UK, and the US.[4] A separate study by the Hong Kong Institute of Chartered Secretaries (HKICS) which examined the board diversity of companies listed on Hong Kong's Hang Seng Index, found that in 2011, about 60% of index companies had at least one female board member.[5] By contrast, a similar report from Credit Suisse found that more than 80% of companies in its sample in Europe and in North America had at least one woman on their boards.[6]

Looking beyond gender diversity, the HKICS study also found that the average age of board members at index companies was 58 in 2011, compared to an average age of about 53 for all public companies. The study also showed that the proportion of index-company directors in their 60s and 70s rose between 2007 and 2011, while that of other age groups fell. "Whilst a degree of seniority amongst board appointees is to be expected, in light of the need for experience and expertise, it is noticeable how few directors are aged 40 or younger," the report notes. "A director is almost three times more likely to be over 70 than under 40."

4 See *2014 Catalyst Census: Women Board Directors,* Catalyst, 2015, catalyst.org.
5 See *Diversity on the Boards of Hong Kong Main Board Listed Companies,* Hong Kong Institute of Chartered Secretaries, 2012, hkics.org.hk.
6 See *Gender diversity and corporate performance,* Credit Suisse Research Institute, 2011, credit-suisse.com.

IMPROVING BOARD DIVERSITY

While board diversity is straightforward in principle, in practice it is about making choices. Companies looking to improve board diversity should therefore begin with a close look at their overall objectives to ensure they're getting the most out of alternative thinkers and other diverse members. The role of the chair is key.

UNDERSTAND THE BOARD'S OBJECTIVES

Creating diverse boards in Asia begins with understanding how their roles and objectives are changing. Traditionally, boards have confined themselves to protecting shareholders' financial interests, reviewing and challenging strategy, assuring good governance, and stepping in for major decisions such as crisis management and large investments. However, in today's business world, the roles of boards have become more transparent and prominent, especially in making strategic business decisions. According to Andrew Kakabadse, professor of governance and leadership at Henley Business School, "a good board is one that positions itself to provide advantages for the business by asking questions like 'What is our competitive advantage? How different are we?'"[7]

Improving board effectiveness through diversity is a step toward achieving these broader objectives.

THINK OUTSIDE THE BOX

To be sure, boards of public companies need directors with deep domain knowledge of the business. In selecting candidates for board positions, having a clear idea of the range of experience already represented on the board is a useful starting point. Any gaps—such as insufficient experience in core businesses, targeted growth markets, or strategic initiatives—should be closed quickly to ensure the board can properly assess ongoing business. The same principle could apply if a business decides to change its business model from business-to-business (B2B) to business-to-customer (B2C), digitize its operations, enter a new emerging market, or go through a large M&A exercise. This should be reflected in the caliber of the new board-member recruits.

Intangible gaps in skill sets—such as not having a variety of approaches to problem solving, and not including different perspectives in analyzing issues based on a mix of experiences and backgrounds—should also be identified and addressed.

Alternative thinkers: The pros

Today, chairs are realizing the importance of injecting "alternative thinkers" into the board composition mix—a trend we see growing. Alain Deniau, one of this article's coauthors, refers to this as "the Darwinism of boards," a

7 For more, see Andrew Kakabadse, *The Success Formula: How Smart Leaders Deliver Outstanding Value,* London: Bloomsbury Information, 2015.

reference to naturalist Charles Darwin's theory of evolution based on natural selection. Boards are moving from being regulatory gatekeepers to strategic advisors that define comparative advantage for organizations—a natural evolution given that continuing the old principles and ways of doing things may subject the organization to the "risk of extinction," so to speak. Meanwhile, a smart board composition today comprises a good mix of members who are relevant to the core business, plus alternative thinkers who are able to hypothesize the "what ifs" of the future. We have observed that this kind of forward-thinking board mix usually attracts greater interest from external investors. Since the world is transforming at a fast pace, companies need some level of "disruptive thinkers" to understand how the business should run in tomorrow's business environment.

Having alternative thinkers join boards can have meaningful impact. They often join as independent nonexecutive directors, and their experience, unambiguous ways of thinking, and strong analytical abilities can benefit the board dynamics. In addition, their new way of doing things and their willingness to develop multi-level contacts with the chair and with other boards can result in more effective communication and hence a more efficient board decision-making process.

Ideally, alternative thinkers offer strong intellectual input with an understanding of conceptual, strategic, and long-term thinking, and the ability to comprehend complex issues quickly. Divergent backgrounds can bring different lines of attack to tackle problems, disruptions that can steer companies away from a tired status quo, and greater flexibility in adapting to a changing environment.

Several companies have truly thought out of the box. They have recognized that astronauts face different challenges—and face challenges differently—than, for example, accountants do. These businesses have leveraged this understanding and recruited astronauts from the Canadian Space Agency (CSA) and the US National Aeronautics and Space Administration (NASA) for corporate boards.

Although this is an extreme comparison, it is not a frivolous one. Looking for alternative thinkers—whether they be astronauts, philosophers, big data scientists, or academics (such as economists)—can bring renewed passion and fresh perspectives to the boardroom.

Alternative thinkers: The cons

However, alternative thinkers can also bring challenges. Their sectoral inexperience could mean they might be slower to get up to speed. Absent deep industry knowledge, veteran directors might not understand their value and could even resent them.

Even an alternative thinker with a strong personality can be timid in such situations, and may require some encouragement to begin asking the tough questions and challenging conventional wisdom. In this case, even the most diverse candidate (on paper) may not be able to unleash their intellect effectively for a company if they are reticent (or worse, silent) at the moment of truth during board meetings. A well-thought-out onboarding program and proper guidance from the chair are therefore key to helping smooth out any negativity or imbalances in board energy. As we'll see, the role of chair requires skillful maneuvering of board dynamics.

Size of the board

Creating room for alternative thinkers also raises questions about the appropriate balance between executive directors and independent nonexecutive directors, and the size of the board itself. Of course, the appropriate balance varies from one company to the next, in part to ensure that suitable information flows from the executive suite. Having a sufficient number of nonexecutive directors also helps ensure that independent, diverse voices are heard.

As companies move to increase diversity, they must also be careful that boards do not get too big. In our experience, two considerations help determine the appropriate size of a company's board of directors:

1. **Is the board large enough to carry out its functions, including committee work, without putting too much burden on individual members?**
2. **Is the board small enough for each member to remain personally involved in governance and interested in board duties?**

These organizational-culture considerations are also important to view through the lens of diversity.

UNDERSTAND THE CHAIR'S ROLE

Getting diversity right, and not only creating—but effectively running—a diverse board of directors, requires a strong chair. Indeed, the role of the board's chair must evolve to include new responsibilities that demand different skills. For example, to ensure the right balance is maintained, chairs must be aware of whether some directors, particularly the alternative thinkers, are being overshadowed, and encourage their more active participation. Chairs must also actively work to calm any tensions that might develop between veteran directors and new members, by keeping the focus on the board's common objectives.

Moreover, chairs must often be the ones setting board diversity as a priority and clearly defining its implications: after all, it is the chair who must help determine and articulate the what, why, and when of diversity for the organization. The focus must go beyond common metrics, such as gender and race, to encompass diversity of thinking. As part of this effort, board chairs must assess any diversity gaps and draft a plan for closing them, bringing fresh ideas and new energy into the boardroom.

Questions to consider include:

1. **How does our board rank across relevant dimensions of the diversity wheel? Where are we strongest, and where do we see gaps?**
2. **How do our gaps affect performance, or our ability to assess risk and challenge the status quo?**
3. **How does our board's range of experience and background align with the company's mid- to long-term strategies? How (and when) can diversity complement or strengthen that view?**
4. **What is our plan to address shortcomings?**
5. **What is the best time to make a change?**

Case study: Consumer products

One global consumer-products company we studied is moving down this path under the guidance of a strong board chair who has made board diversity a priority. Notably, he is clear in his communications (internal and external) that the board's desire for greater diversity does not stem from a knee-jerk reaction or quota system, but from a need to have the board match the mix of nationalities, age groups, gender, and cultural backgrounds of its increasingly global customers.

The organization's culture also plays a role. "Our culture and DNA drive an emotional connection with our customers, and that's what has made us successful and got us to where we are today. And we can't forget that," the chairman of the consumer-products company notes. "Diversity is important, but it should not affect our existing culture but rather strengthen it. Building a diverse board should lead to a diverse ex-co team. Step by step, this diversity mind-set promoted at the top will cascade down to the organizational level."

Although still in the early days of implementation, the results thus far have been impressive:

- **More challenging questions are being asked at board meetings.**
- **Board meetings are more dynamic and energetic, and boards are smaller.**
- **There is more ongoing contact among board members outside of scheduled meetings.**

However, new board directors, who are very different from the traditional members, can also be seen as disruptive forces in the boardroom. As the chairman strongly affirms, "it's very important to retain our organization's culture, despite the new energy brought in by the new hires."

Case study: European conglomerate

The chairman of a European motorway conglomerate felt the company was no longer moving forward; to determine what the board could do to change this, he began looking at the dynamics of the group and in particular at the discussions taking place at board meetings.

Through a series of conversations, the chairman began to recognize that the group lacked a clearly articulated sense of its guiding principles for the company. When asked to describe their business, responses ranged from "road construction" to the much more comprehensive "infrastructure that connects people from one end to another, in the safest, and most comfortable, cost-effective, and efficient, manner." Further meetings helped the group align on a clearer idea of what success looked like: Serving customers and understanding their future needs.

With this guiding principle in mind, the board sought out new, diverse members who could help bring it to life, including a big data expert proficient in converting data from large customer groups into useful business intelligence from both strategic and technical standpoints. This new director (a woman), together with other highly accomplished and diverse board members, brought in new perspectives and ideas to the company and helped the chairman to better communicate his strategy and the company's new business model to the team.

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