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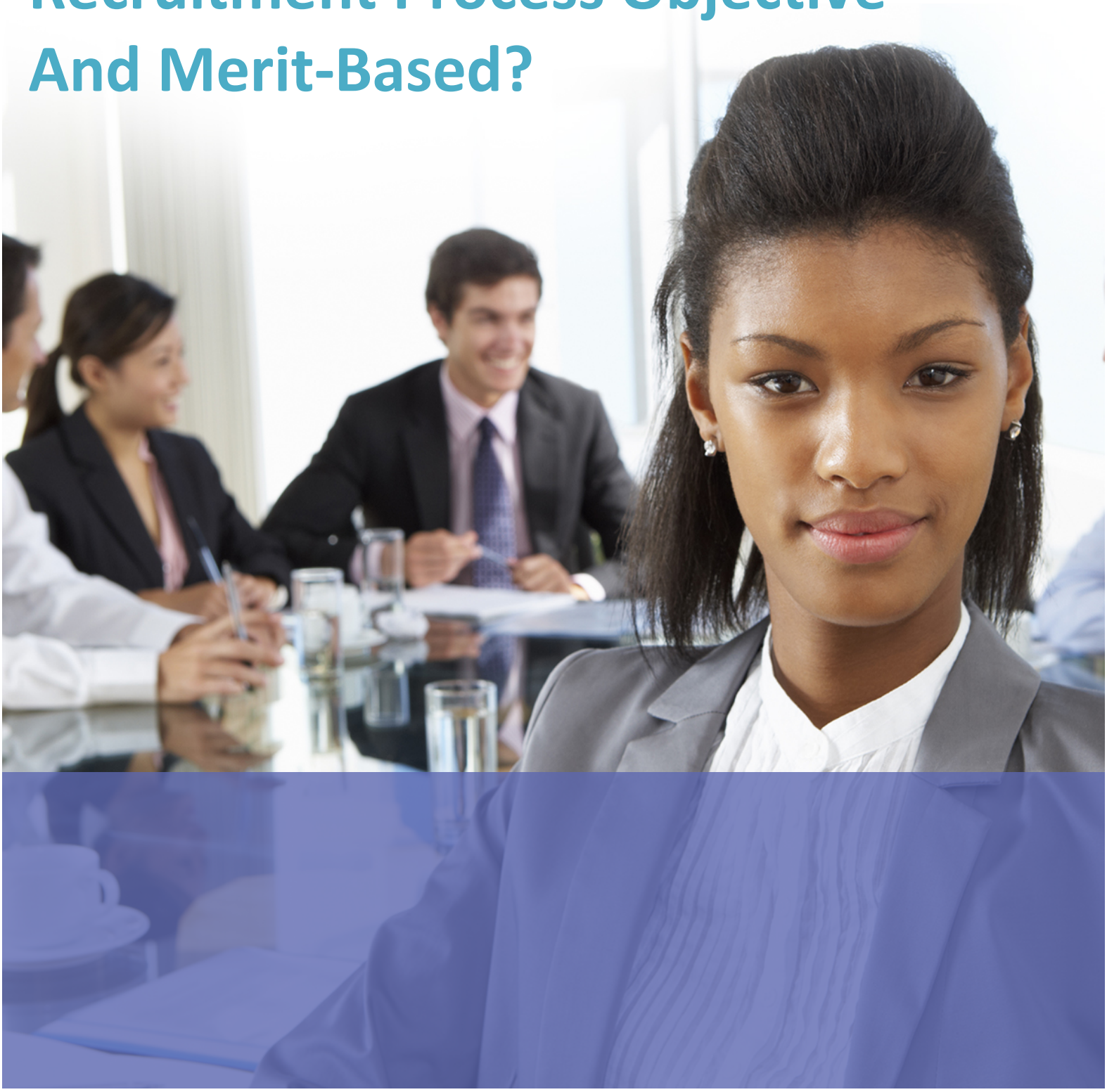
Diversifying Your Board - Is Your Recruitment Process Objective And Merit-Based?



Diversifying Your Board:
Is Your Recruitment Process Objective And Merit-Based?

Overview

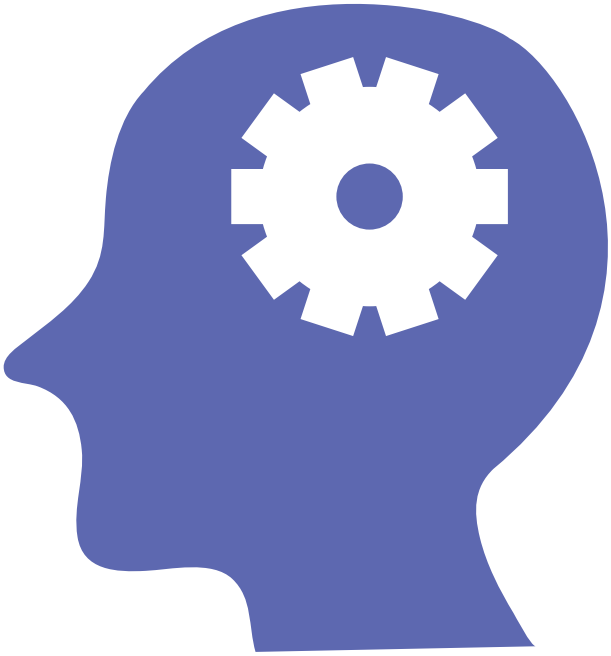
Investors, regulators and the government want to ensure Canadian boardrooms are composed of the most effective, relevant and diverse Directors possible. During the 2015 proxy season, for the first time, Canadian non-venture issuers were required to report on the new corporate governance disclosure rules regarding the number of women on their Boards of Directors.[i]

Torys LLP analyzed 179 of the 243 companies listed on the S&P/TSX Index that had, as of May 10th, filed their 2015 proxy circulars. With 71% of the Index represented, the preliminary study shows that:

- 44% of issuers have no policies for increasing the number of women on their Boards
- 56% have adopted formal policies for increasing women on their Boards
- Of the 56% that have policies, only 13% (24 companies) had measurable targets

Of the 44% with no formal policy, 32 issuers disclosed no reasons for the lack of diversity policies. Of the rest, the reasons most commonly cited for the absence of a comprehensive diversity policy were:

- Their Board candidates are selected based on merit (86 issuers)
- It would not be in the issuer's and/or shareholders' interests (17 issuers)
- It would be unduly restrictive and reduce the Board's flexibility (16 issuers)
- The targets would be arbitrary and ineffective (16 issuers)
- The level of diversity is already adequate (10 issuers)
- They want to select candidates from the broadest talent pool (8 issuers)
- The industry is male-dominated and the female talent pool is too small (5 issuers)
- A policy change was currently under consideration (2 issuers)[ii]



It has been only six months since the new disclosure rules came into effect, and although most financial institutions were not required to report at the time of the study, the early results aren't very encouraging: almost half of the S&P/TSX Index companies indicated a reluctance to improve the transparency of any measures being taken to increase the number of women on their Boards.

What is interesting about the results, however, is that the issuers' explanations don't reflect the reality. In truth, selecting Directors based on their merits, being unrestricted, having flexibility, acting in the best interests of the company and shareholders, and being able to recruit from a broad talent pool are all factors that are *congruent* with considering diversity and not reasons to *exclude* it. The misguided belief that there aren't enough qualified women in a particular male dominated industry is a matter of misinformation and a result of entrenched thinking and bias, and, consequently the broader pool of non-traditional and qualified talent that actually exists is often overlooked. The New York Philharmonic is a great example of entrenched thinking and bias; it is also a great example of how change is possible.

Competence And Diversity Are Not Mutually Exclusive

For decades, symphony musical directors hired male musicians to the exclusion of female musicians. The contenders were handpicked male students who studied under a select group of teachers, or those who attended a well-known school. The bias against female musicians was they did not have the proper technique or stamina and thus would lower the quality of the symphony's music. In other words, "There were no 'qualified' women".

A racial discrimination lawsuit against the New York Philharmonic became the catalyst for change. The orchestra began to change its hiring practices by broadening the talent pool, advertising openings and allowing orchestra members to participate in hiring decisions. They also introduced the use of blind auditions, in which musicians auditioned behind a curtain or screen, allowing them to be heard but not seen and thus judged solely on their musical talent. As the number of blind auditions increased, so too did the number of women being hired.

A November 2014 survey conducted by Sudy Raman looked at gender representation in America's top 20 orchestras, represented by 1,833 individual musicians. The orchestras, on average, had 63% men and 37% women. Before introducing blind auditions, the 103-member New York Philharmonic had no female musicians; after their introduction, the number rose to 44 female and 63 male members.[iii]

The use of blind auditions has now become the 'best practice' among symphony orchestras across the US, and as a result, the number of female symphony members has increased exponentially. Female musicians are now hired through a process where merit and competence are paramount. And yet, prior to blind auditions, these same female musicians would likely never have had the opportunity to demonstrate their competence: they would have already been discounted because of their gender alone.

Are Canada's Boards Recruited Based On Merit?

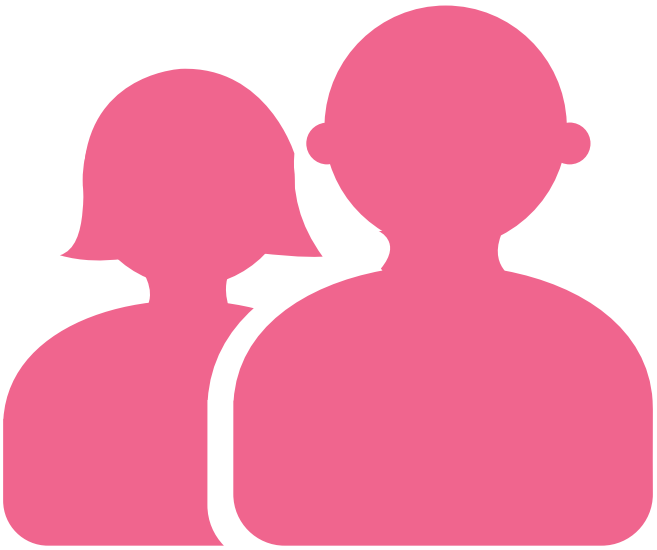
While it is most definitely true that women should be recruited to Boards based upon merit and competence, and not based upon their gender, the same is also true for men. However, given that Board recruitment has historically been done through word of mouth and largely from within the existing networks of those already around the Boardroom table, it's

improbable that a truly merit-based process is used. Thus, a troubling double standard persists.

The unfortunate fact is that the vast majority of Boards do not engage in an objective and merit-based recruitment process to hire new Directors, although many believe and/or say that they do. Boards that engage search firms to aid in the recruitment process certainly benefit from a wider talent pool, but search firms also fall prey to the out-dated and inherently biased recruiting methodologies that have been in use for over 20 years -- methodologies that actually *preclude* a truly objective and merit-based process. These methodologies favour a more homogeneous group of people and indulges in impression-based hiring wherein the selected candidates are more personally liked or appear to "fit well with the Board", regardless of the candidate's true ability.

Gender Quotas

The Torys study cited earlier demonstrated an ongoing reluctance on behalf of many companies listed on the S&P/TSX Index to take Board diversity seriously and to implement a comprehensive policy on Board diversity. While the overall study results are disappointing, they're not entirely surprising. They may also demonstrate Canada may be following a path similar to the Norway experience.



The Norway Experience

Norway was the first country to introduce legislation detailing the requirements for representation of both genders on the Boards of Directors for all publicly listed companies. It is estimated that in 1992, women accounted for only 3 per cent of Board positions in Norway's publicly listed companies, a figure that rose to only 6 per cent by 2002[iv].

With limited progress being made, legislation was required to improve the representation of women on company Boards. At a hearing in 1999, the Ministry of Children and Equality presented a proposal for gender quotas on corporate Boards, the first of its kind. While originally intended as part of a revision to the Gender Equality Act, it was later introduced as an amendment to the Norwegian Public Limited Liability Companies Act ("Companies Act")[v].

The parliamentary bill consisted of the following measures:

- an obligation for state-owned companies and public limited companies to ensure a voluntary minimum share of 40 per cent women on their Boards by January 1st, 2004, and July 1st, 2005, respectively
- a request that an agreement be reached to increase female Board membership in

public limited companies to 40 per cent, with the understanding that the gender quota legislation would be withdrawn if gender balance was attained[vi].

Based on this parliamentary bill, in 2002, the Conservative-Centre government proposed the adoption of Board gender targets as a voluntary measure for all public-limited companies in the private sector[vii]. Gender quota requirements would also apply to all publicly owned enterprises. Despite much opposition at the outset, the motion was passed in 2003 after garnering considerable support from both the Labour Party and the Socialist Left Party.

By July 2005, it was evident that voluntary compliance with gender balance targets failed, as public-limited companies reported female representation on company Boards at only 12 per cent. Consequently, the legislation became effective January 1st, 2006, with a two-year transition period before sanctions for non-compliance were enforced.

Global Perspective

Since Norway legislated quotas, many other countries have followed suit. France, Spain, Switzerland, Belgium, Iceland, Italy, Germany, Malaysia, India, Israel, Kenya and Brazil (for state-controlled firms only) have all legislated quotas of varying percentages. Other countries, including Britain, Sweden, Denmark, Finland, Australia, the Netherlands, Singapore and Japan, have opted for more voluntary actions, including "Comply or Explain" measures. The governments of Britain, Australia and Sweden have threatened to impose quotas if the number of women on Boards doesn't improve substantially within a specific timeframe.

North American Perspective

The US and Canada have lagged behind most of the western world.

In the US, the Securities and Exchange Commission (SEC) added a new diversity disclosure requirement in February 2010 in which companies must disclose in their proxy statements *whether and if so, how* nominating committees consider diversity during Board appointment proceedings[viii]. US companies are also obligated to disclose how the Board evaluates the effectiveness of the diversity policy. In 2013, California passed Resolution SCR-62, the country's first legislation of its kind. Resolution SCR-62 is nonbinding, and urges that by December 2016, publicly held corporations in California with nine or more Directors have at least three women on the Board; companies with five to eight Directors have at least two women on the Board; and companies with fewer than five Directors have at least one woman on the Board.

In Canada, in addition to the provinces that fall under the recent Ontario Securities Commission (OSC) "Comply or Explain" rule, Quebec is the only province with legislated quotas, passing legislation in 2006 with the goal of establishing parity and equality for state-owned enterprises by the year 2012. Last year, Liberal Senator Céline Hervieux-Payette, a long-time quota advocate, introduced a private members bill called the Board Of Directors Modernization Act. The act received a second reading in the Senate and was referred to the Standing Senate Committee on Banking, Trade and Commerce, which, if passed, would require the composition of Boards to be composed of at least 40% of either gender.

The Statistics in Canada remain bleak and speak for themselves

In 2013, an OSC survey showed that out of 1,000 TSX issuers:[ix]

- More than half (57%) had no women Directors
- 53% admitted women held fewer than 10% of executive office positions
- Only 3% had three or more female Board members
- Only 3% had females leading their Boards

A 2014 Catalyst survey on female Board Directors[x] found that:

- In the FP 500, women hold only 14.5% of Board seats
- In the FP 500 women hold only 5.1% of CEO positions

A 2014 study of the FP 500 by the Canadian Board Diversity Council (CBDC)[xi] showed that:

- 25% had Board diversity policies, 62% did not. Of the 62% that did not have policies, 62% said they didn't need to adopt one
- 78% of Directors believe their Boards are already diverse
- 21% always use search firms, 44% sometimes did, and 28% never used search firms
- When recruiting Directors, 39% always use their personal networks while 51% sometimes use their personal networks

The key impediments to Board diversity continues to be:

- Board leadership that is not truly committed to diversity
- The lack of 'true' objective and merit-based Board recruitment practices
- Too many Directors who don't care about diversity – as evidenced by 78% of Directors believing their boards are already diverse, despite the statistics which prove otherwise
- Boards that continue to recruit from within their own networks
- Double standards and bias of all types
- The misconception of there being too few qualified women
- Long-tenured Directors
- The lack of proactive and transparent Board renewal strategies
- The lack of sponsorship for women
- Not enough women in operational roles that lead to the top jobs

New Trend for Quotas

There is no doubt that gender quotas are controversial, and many members of the business community have been against it, women included. Though it should be noted that the trend against quotas is shifting. According to a survey by Grant Thornton, the number of business executives who favour quotas is on the rise around the globe, which indicates that more leaders are warming to a quota system. In fact, 45% of international business leaders supporting quotas, a promising increase from 37% just two years ago[xii].

Regardless of which side of the quota debate you are on, one thing is clear: the status quo in Canada cannot continue and if it does, Canada may find itself in the same position as Norway and several other countries: that only by legislating quotas will hasten the pace of change.

In Summary: The Need For True Merit-Based Practices

As we have already discussed, governments and regulators around the globe have put the microscope on the issue of the lack of women on boards, and government intervention in the form of quotas is on the rise. In addition, investors want to know that the companies they invest in have the strongest and most relevant Directors possible, and they are becoming more vocal about the lack of merit in the current way boards are recruited.

It's quite obvious that the lack of a truly objective and merit-based recruiting process impacts board performance and this is of great importance to investors. Equally obvious is that this deficit is one of the leading contributors to the glacial pace at which women are being selected for Board positions. Both investors and diversity proponents will agree that the issues of Board performance and Board diversity are closely inter-related and both issues can be resolved through the same recruiting process improvements.

Board leaders should commit to a thorough review of their current recruiting practices to identify the weaknesses that preclude them from engaging in a rigorous, and truly objective and merit-based recruitment process. This must include an in-depth and honest analysis of how 'fit' is defined and how it informs decision-making. The term 'Fit' has become a frequent and easy way to eliminate those candidates who are different from the interviewers, and to justify proceeding with individuals who are more like-minded, and with whom there is a preference to want to 'spend time with'. These personal judgments and assumptions influence decision-making without considering all of the relevant information. Boards need to move beyond this 'clubby' camaraderie, and move towards a more thoughtful and robust process.

Identifying and remedying those weaknesses will result in a composition of Directors who possess relevant skills and experience, a broad range of collective attributes and different perspectives -- all qualities that should absolutely be in alignment with the strategic needs of the business.

Having a truly diverse Board of Directors is not only the wave of the future; it's the scenario that makes the best business sense. Boards that are comprised of men and women with 'the right' blend of differing skills, experience, perspectives and characteristics are better equipped to provide stronger governance and oversight, and provide relevant consultation and support to the CEO. Diverse boards are also less prone to "group-think" and thus achieve a more robust understanding of opportunities, issues and risks. By having a variety of experiences and perspectives to draw from, the quality of a board's decision-making will improve, sensitive topics will be more openly discussed, sustainability will be enhanced and overall performance will be stronger.

About The Author

Gillian Lansdowne is the founder and CEO of Lansdowne Board Intelligence Inc. She has over 20 years of executive search expertise working with Canadian and international clients around the globe.

Lansdowne Board Intelligence (LBI) is uniquely dedicated to building effective and diverse Boards of Directors. LBI assists organizations of any size and complexity to recruit 'the right' Directors, optimize the board's composition, and equip the Board with objective and merit-based practices where competence is paramount and diversity is imperative.

(416) 929-6969
gillian@lansdowneboardintelligence.com
www.lansdowneboardintelligence.com

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[i] British Columbia, Alberta and Yukon excluded.
[ii] Torys – "Women in the C-Suite; Can securities law advance gender equality?" by Rimna Ramchandani, Glen Johnson, Michele Cousens.
[iii] November 2014 survey by SUba Raman on the gender representation in America's top 20 orchestras.
[iv] Storvik, A. & Teigen, M. (2010). Women on Board – The Norwegian Experience. Friedrich Ebert Stiftung.
[v] Storvik, A. & Teigen, M. (2010). Women on Board – The Norwegian Experience. Friedrich Ebert Stiftung.
[vi] Social and Economic Council of the Netherlands & Vrouwen in beeld. (2007, November). *Balancing the Boardroom*. Background information symposium, The Hague, the Netherlands.
[vii] Storvik, A. & Teigen, M. (2010). Women on Board – The Norwegian Experience. Friedrich Ebert Stiftung.
[viii] Catalyst. (2010). Women on Boards. Catalyst Quick Takes.
[ix] July 30, 2013, the Ontario Securities Commission (OSC) published a consultation paper (the Consultation Paper) on advancing the representation of women on Boards and in senior management of public companies.
[x] 2014 Catalyst Canada Survey.
[xi] 2014 Annual Report Card CBDC.
[xii] 2014 Grant Thornton: *Women in Business: From Classroom to Boardroom*.