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The Challenges of Attaining Growth:

The Blenheim & MGSM Insight Series

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"Superhuman effort isn't worth a damn unless it achieves results"

Sir Ernest Shackleton

Chapter 1

Board Diversity – Beyond Demographics

“What are we missing given the narrowness of our lens on diversity?”

Australian Boards are pursuing a simplistic, demographic notion of Board diversity that stifles the search for talented Directors and misses the essence of what is necessary to assemble effective Boards.

Chapter 1: Board Diversity – Beyond Demographics



“If you do nothing you get nothing”

Aung San Suu Kyi

Diversity and membership composition of Boards were strong themes raised by participants as areas needing to be addressed to assist Boards in driving growth.

Many participants felt the discussion of diversity of Boards was being framed in narrow, demographic terms, with gender at the forefront of the debate. There was agreement that getting more women represented on company Boards was an important initiative and should continue to be progressed, as evidenced in the following quote from a senior Chairman and Director, **“Gender is an important part because I think it does, in my experience, change the conversation when you have at least two women on the Board”**.

The specific reference to having **“at least two”** women on the Board is indeed consistent with research showing that the **“magic number”** for giving women a voice and influence on company Boards is two or three, depending on the size of the Board.⁶ Australian Chairs seems to have an intuitive, if not explicit, understanding of this **“critical mass”** principle.

However, limiting the discussion of Board diversity to gender alone is masking the need to achieve a broader concept of diversity on Boards. As indicated in the following comment:

“I think diversity has nothing to do with limiting ourselves by counting the females and males around the Board table. I know of some Chairman simply trying to facilitate equilibrium which is a tick the box process.”

Indeed adding to this point another Director stated we are **“obsessed with gender in this country, we need diversity of background, walks of life and geographies”** where this **“overemphasis on gender balance can lead Boards away from what truly matters in terms of diversity”**. Academic research also tends to conceive of Board diversity in terms of gender and, to a lesser extent, ethnic balance. The vast majority of the published research studies focus on one or both of these variables. Some studies do, however, introduce additional aspects of Board diversity like nationality, industry experience, and political ideology^{7,8,9,10}.

In general, research examining multiple dimensions of diversity concludes that *“non-demographic”* factors play a greater role in firm performance than gender and ethnicity.

However, research also suggests contingencies for when certain dimensions of Board diversity will add value or not. For example, having a Board comprised of Directors with varying industry backgrounds may not be suitable for *“internally-complex”* firms requiring specific expertise in a rapidly changing technological environment¹¹. Regardless of the specific dimension of diversity under consideration, creating diversity for the sake of diversity may not improve, and can even impede, Board performance.

One participant went even further and said the push for gender representation on Boards is doing nothing for *“real”* diversity but rather maintaining the homogeneity of Boards, because whether men or women, they tend to have very common backgrounds e.g. professional lawyer, accountant or investment banker. This lack of understanding of a broader definition of diversity and acting upon it were seen as impeding Boards in their thinking regarding growth and growth initiatives.



Diversity of Thought

As one participant stated, *“you need diversity on the Board from a whole range of different perspectives. Not just gender diversity. ... I think there’s a much broader diversity requirement. You know if I look at the corporate Boards of Australia and say do they reflect Australian society, the short answer is no, they don’t.”*

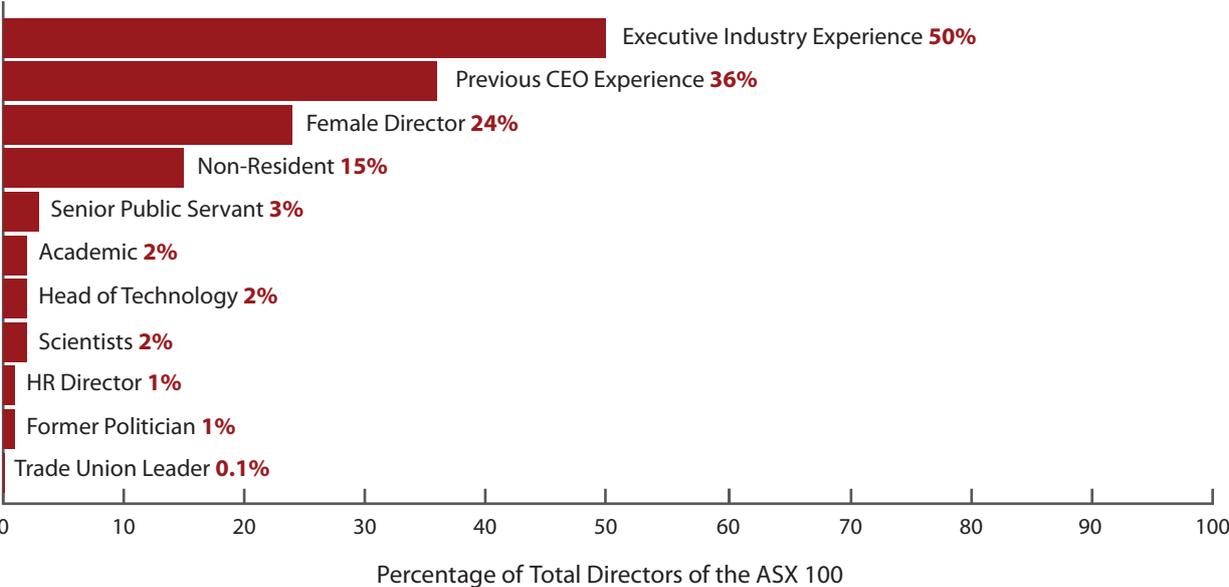
When diversity as a theme was raised in the discussions with participants, it was rarely raised alone. The discussions were more centred on the *“need to get new thinking into Boards”* and *“ways to get alternative views”*. Thus the terminology used by participants regarding this broader definition of required diversity on Boards was more in terms such as:

- *Different “voices”;*
- *Exposure to different backgrounds e.g. Scientists, PhDs, Trade Union officials, Public Sector employees;*
- *Walks of life;*
- *Geographies;*
- *Cultural backgrounds;*
- *Thought e.g. not linear in thinking;*
- *Experience;*
- *Edgy people (restless energy) – the need to know where to be in the medium term;*
- *International “mindset” or “significant international appreciation”;*
- *International experience/networking knowledge or “immersion” in the culture of the markets being targeted;*
- *Entrepreneurship; and,*
- *Risk orientation.*

“If everyone is thinking alike, then somebody isn’t thinking”

George S. Patton, Jr.

Figure 1: Current data of the composition of the ASX 100 Boardrooms based on the individual backgrounds of each Non-Executive Director. It highlights the lack of diversity in a range of occupational backgrounds, May 2015.



Diversity of Occupational Background

Participants were quite open to exploring the future Directors with a broader base of occupational backgrounds than those traditionally preferred. Figure 1 above shows the current data for the ASX 100 and highlights the lack of diversity in a range of occupational backgrounds, some of which we explore in more depth.

Scientists

The comment by one Director on a global Board lamented the fact that we do not consider Scientists, PhDs or Public Sector employees as is done for example in the US (only 2% of the ASX 100 total pool of Directors have a scientific background). The point is that each of these categories is different from the homogenous nature of many existing Directors and Boards. In the case of scientists, they “are deep thinkers and see things differently” and have done so in environments such as research and development where innovation and thought breakthroughs are the objectives, certainly attributes worthy of consideration on Boards. In the US, in the Fortune 500 there are a considerable number of examples of scientists on Boards, as well as academics.

Given the increasing importance of information systems, sustainability, biotechnology, and efficiency in debates about financial growth, this idea seems far more worthy of discussion¹².

Senior Public Servant

Regarding Public Sector employees, despite sometimes being critical of the Public Sector, the size, scope and complexity of the Public Sector is comparable to that of the ASX top 50. Examples include the Departments of Defence, Health, Education and others, where the cross-fertilisation of ideas would be beneficial for both the private and public sectors. This suggestion was well received by participants in the study when raised, and could be seen as a positive move to break down the homogenous nature of existing Boards highlighted above (only 3% of the ASX 100 total pool of Directors have a public sector background).

Academic research mirrors the sentiment of the participants interviewed here, noting specific benefits of including public sector employees on corporate Boards. More generally, government sector representation may be able to improve company Board performance in areas where the public sector may adopt more explicit policies and guidelines¹³.

Academics

The same could be said for considering academics on Boards (only 2% of the ASX 100 total pool of Directors have a public sector background). With the ongoing debate regarding de-regulation of universities and the standard of education is there not an opportunity to have leading academics particularly those who lecture in business become more prevalent on Australian Boards. The lecturers are there to educate and influence the thinking of our future business leaders but are regularly called into question on their teaching of historical theory as opposed to relevant and practical theory.

Would it benefit both the business sector and education sector particularly to have academics on the Boards of Australia? On one hand, this kind of relationship would inject specific expertise in relevant areas directly into Board decision making. In addition, it would offer academics a chance to understand the corporate world and perhaps to introduce new ideas, more efficient processes, and strategic thinking into the university sector. From this perspective, it is a “win-win” situation. As one participant put it, **“whether current business academics are equipped to do this is probably the question”**.

Former Politicians/Human Resource Directors

Other suggestions that came up for consideration in the survey were ex-Politicians (only 1% of the ASX 100 total pool of Directors have a political background) and ex-Human Resource Directors (only 1% of the ASX 100 total pool of Directors have a human resources background).

“Politicians have the ability to work for a cross-section of people, have a history of building relationships and can be successful in opening new markets. Those that understand business may be a useful addition to the Board.”

“The favourite line of all companies is that our most important asset is our people. Yet I am not aware of any Head of Human Resources or ex-Head of Human Resources on Boards in Australia. Company culture is key to driving results and those that have built a career in supporting company culture such as Human Resources executives, for some reason are not on Boards. I am reminded of that quote ‘culture eats strategy for breakfast’. If that is the case then culture drives growth. Then I ask the question, would it help to have ex-HR Directors on the Board. In my opinion, a good HR Director is someone who has been a Head of Division, ran a P&L and then moved into HR and supported the CEO and organisation. That type of person I believe could have a role on the Board.”

In general, academic research is in agreement that it may, indeed, be a good idea to include politicians and ex-politicians on corporate Boards, especially in heavily regulated industries. Not surprisingly, in more heavily regulated industries the percentage of Directors with political backgrounds tends to be higher. The downside is the polarisation of political views where ex-politicians as Directors from one side of politics could create difficulties for the company if that side is not in power.

Trade Union Leaders – Observations of Europe

If we examine the global powerhouses who consistently have achieved growth Germany is one country that arises in discussions. The German

worker has six weeks holiday and yet very high productivity and a heavily unionised workforce. There is a significant difference between the approach of the employer and employee and the relationship in that the Germans work in a collective spirit with co-determination rights. In some cases worker representatives hold seats on Boards, or secondary Boards. In Australia it seems that we work with the view from the worker **“that the bosses are out to get us”** and from management that **“the workers aren’t productive.”** Perhaps there is an opportunity where ex-Union Leaders would benefit by joining Boards and companies would gain a better understanding of their approach and views. As one participant said:

“I have known numerous union heads and they have intelligence but lack business reality. I have known Chief Executives who have a great business reality but cannot get their message across the floor. Sounds like bringing the two together would be mutually beneficial.”

Challenging the Existing Set of Board Competencies

There is clearly a shift in thinking as to the competencies that participants think are required on Boards. This is evident with participants referring to an “old” set of competencies required of Directors in the past, which some described as ‘vastly overrated’ in today’s world. The participants’ responses in Figure 2 show clearly the view that the traditional Board competencies of accounting, legal, compliance and risk, in many respects the mainstays of existing Director competencies, to be somewhat over-represented on company Boards. Participants generally are not saying these competencies are not required on Boards, but rather the increased regulatory and governance environment has resulted in “a creep” of these competencies on the Board. Others express the view that there are alternative means for Boards to access these skills as opposed to Board membership.

“Boards need to be functional. I don’t agree with the need for a lawyer on the Board or a former auditor. We can outsource these skills.”

A Window into what are Potentially the New Board Competencies that will Emerge

By contrast to Figure 2, Figure 3 shows the competencies participants believe that Boards should have more of. These competencies of international, social media, technology, digital, executive experience and industry experience fall into the category of what may be termed experiential competencies, or those involving or based on experience and observation – an interesting shift from the traditional educational/professional based competencies.

Figure 2: Participant Responses to the Question “Which of the following competencies should Boards have “less of” to facilitate growth and success in the future?”

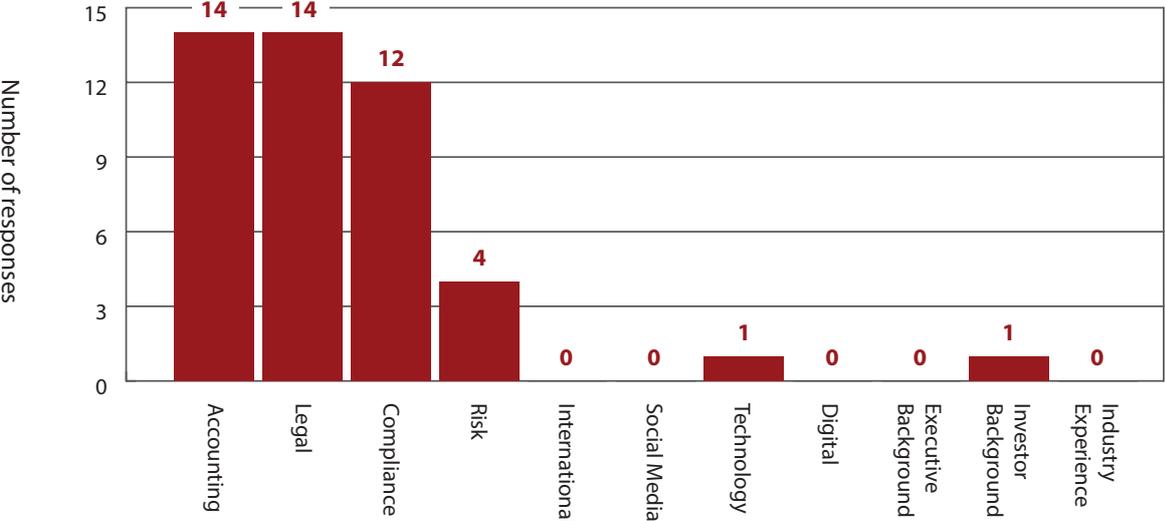
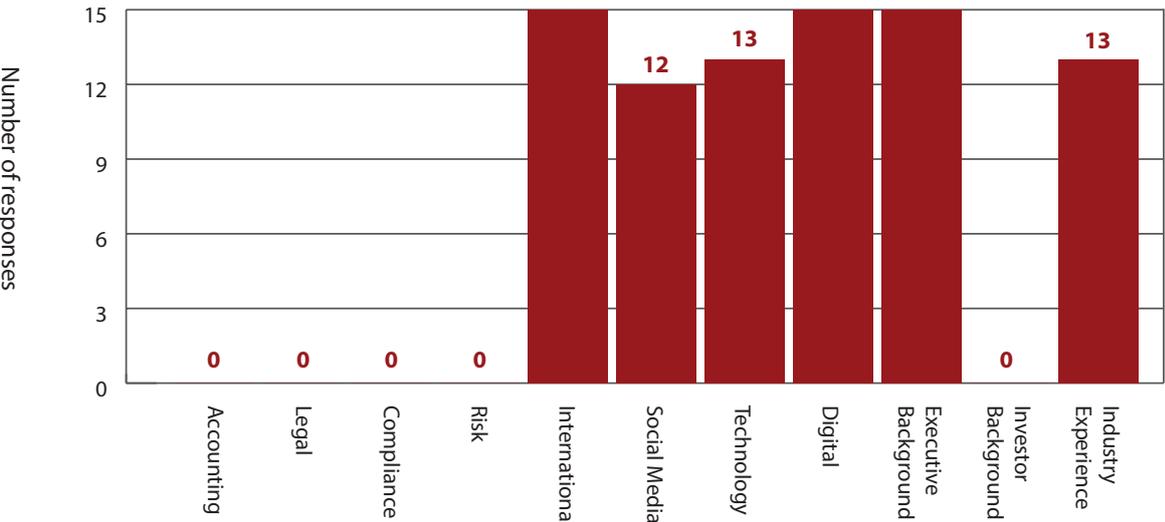


Figure 3: Participant Responses to the Question “Which of the following competencies should Boards have “more of” to facilitate growth and success in the future?”



Note: Response numbers vary as participants may not respond or may respond to multiple competencies.

This growing dissatisfaction with the “old” set of competencies is also reflected in one Director’s comment that *“Board members need to ‘think’ and be able to get across all issues. They all need to contribute across the broader business”*. This need was specifically contrasted with Directors with the more traditional educational/professional competencies as being *“stuck in the silos where they came from”* and hence not contributing in this broader fashion. This is supported by another participant comment, *“What I find with a lot of Directors they are still stuck in the silo that they came from. They are an accountant, a lawyer or whatever it might have been and that is where they feel they can make the most contribution and therefore that’s where they try to steer most of the conversation”* and *“Most Directors need to understand strategy better, they focus on incremental growth/*

change and don’t ask enough about the why, to make leaps forward in substantial growth.”

The comments above clearly show that even those competencies where it was identified that “more of” was needed were underpinned by the view that having this competency was not enough, and not primary for Board membership. Subject matter experts or specialist knowledge is not enough to force a Director out of a silo, indeed it reinforces silo mentality if the Director does not have the all round general competence to contribute on the broader spectrum of issues. Board members who sit there and wait for their specialisation to arise on the agenda or steer the agenda to this are not the preferred Director.

A number of these emerging Board competencies are examined in more detail below.

Industry Experience

Pursuing diversity of 'intellectual capital' on Boards creates problems if members do not have backgrounds in the specific industry. Basic aspects of the business can be difficult for Board members of different professional backgrounds to understand. As one Chairman stated ***"It is so complexwe are just a very complex business and new Board members struggle with it. New Board members that don't have an industry background struggle with it."*** Some were more straightforward in their views on the need for an industry background, ***"I would prefer one expert and hear their view over and above that of the lawyers and accountants discussing the issues around governance and risk. In saying this, the industry expert will have financial acumen and be broader in their view. They may well have been a CEO or COO who brings insights that a professional collective of similar backgrounds may not"***.

As noted briefly above, assembling Boards with a broad background of industry experience may not always improve Board decision-making. Too much diversity in industry backgrounds may actually be inappropriate for firms requiring expertise in a specific area where the rules of the game change rapidly. This is perhaps another way of saying that in industries requiring a great deal of technical expertise (e.g., biotechnology, IT, health sciences, etc.), industry experience among a large percentage of Directors is positively correlated with business growth¹⁴.

Technology/Digital

With the dramatic advancements in technology, particularly in digital and the impact on potential business revenues, executive structure, company positioning and even company existence, there was extensive discussion around the need for having a technology specialist with broad business acumen as a member of the Board.

The converse argument was to ensure individual Board members had a minimum of ***"technology savvy"***.

"I can see when there is a need for an outstanding digital person on a Board, to bring the Board up to speed and be an outright champion. Digital brings the company closer to the customer. Digital however, is merely a reflection of the Board and whether the executive has the appetite for change."

"For digital to succeed there needs to be the right mindset. That is the ongoing development of knowledge and curiosity. This is not limited to individual Directors, it has to be across the business. The Chief Executive has to recognise the risk of the future and re-inforce that to the Board."

We expand further on the impact of technology, digital, digital disruption and social media in the later chapter "Digital Disruption and IT Driven Innovation."

International Mindset/Experience

More of these competencies does make sense in terms of growth. International in particular fits the bill. This century is talked about as the Asian century and Australia is in close proximity to Asia. The question is as a country that wants to capitalise on this and export to where 60% of the world's population resides, ***"have we immersed ourselves in understanding our future customers and therefore how many non-Australian domiciles are there on Australian Boards."***

"The challenge of having a non-resident on the Board is the issue of distance. However, bearing in mind that such individuals have the capability of introducing relationships, opening trade opportunities and educating fellow Board Directors, it would seem with today's current technology that distance is a poor excuse."

Perhaps most importantly, diversity in international experience among the executive team is positively associated with firm financial performance, especially in companies operating in a wide range of geographic markets¹⁵. So, on balance research supports the idea that having international experience on a company Board is a good idea, however many participants interviewed highlighted the difficulties of having non-resident Directors on Boards due to time zone differences and the lack of integration into discussions and decision making. The reality may be that Boards will need to find an effective way of dealing with this.

The construction of the Board – there are alternatives!

The participants were also not shy in saying that ***"there are sometimes better ways to get diversity and specialist competencies on the Board than through Board members directly"***; clearly acknowledging that Board members can't be experts in everything. These alternative sources included advisors, consultants, industry and product specialists, and a junior or advisory Board that captures a demographic viewpoint e.g. the view of the millennial generation birth years 1980-1999. This approach is another way of injecting differences in thought and orientation to challenge the more homogenous backgrounds of many existing Boards.

So when constructing a Board and selecting Directors the following was articulated:

"What is essential to the Board is a general command of thinking and business, plus a specialist. I also think people over 40 who have lived a little and have financial independence. They need standing and of course, basic financial literacy."

"What we really need is diversity and inclusion. There is no use having a Board full of diversity if no one listens."

"Board members should have a good commercial brain, good communication skills, understanding of the business, with relevant experience and expertise. It is taken as a given that they have financial acumen, and nice to see would be a well-rounded HR executive or ex-CEO."

"On a Board I would like to see an ex-CEO, some industry experience, edgy people and those with energy. Vastly overrated skills are legal and commercial governance. An international Director is also key. Some people have argued that there are not enough young people on Boards. My thoughts are, if at 30 they are so good in their field, why would they want to be on the Board?"

"Men and women of character."

"Boards require human chemistry. An effective Director may, for example, have a thorough understanding of an industry's complexity e.g. maybe a biology or drugs expert for a biotech sector."

"The Board capability has to be high or higher than the capability of the CEO because the Board sets the tone. They can kill a company. They can go slow on deals. They can stop progress. They can force execs to leave or they cannot be across the issues and fail in governance. The Board doesn't execute, that is management's role. You need a diverse Board of differing perspectives and experience. I expect them to have a big picture view. Furthermore, if you have a low capability Chair, you have a low capability Board."

"I pick a Board on contribution, not a Board of names. Boards need individual and collective judgement. Choose those that have the courage to think laterally and to be different."

"It is good to have people on a Board with a wide view of the world. Good to have international experience on Boards, if you are going to compete in overseas markets. Industry experience is critical."

Perhaps a good summary articulated by one participant on the dilemma of appropriate Board composition follows:

"I am very concerned about the young professional Director. I feel the old club dynamics of having a collegiate Board is also not the appropriate answer for the future Boards. This process and the discussion on the breakdown of diversity has made me think a lot more. I believe the Board has a critical role and should be fit for purpose. If I used a sporting analogy, take the Tour of France where you have a team that can all cycle and share a common goal. You have a mountain climber, you have a sprinter, you have a grafter. In the Boardroom we need people who have good general business acumen and skills but also some areas of deep expertise. In your matrix you outline sector experience, CEO experience, IT/Digital experience and others which I believe are required but not in every

Board meeting. But like the Tour de France skills are required at certain times and thinking from the Board is required and at times needs levels of expertise to drive a debate. Having individuals who have not lived through outcomes in their career, who are the young professional Director concerns me if they haven't got life experience, and to the counter, the 70 year old club also concerns me when they are hired from a similar cloth without in-depth expertise. In regards to technology, does the 70 year old know the question to ask of the executive team? Does the young Director know the consequences of an international/offshore acquisition and know what to ask of the executive. My point is our discussion of diversification has reached gender, when I need diversity of thought and experience in the Boardroom."

Given the views expressed on the new competencies required to be considered to make Boards more effective and growth orientated the comment from one participant certainly gives pause for thought as to appropriateness of current Board composition.

"If you actually ran the rule over Australian Boards and asked what does each Board member bring to the Board, what is their contribution? What is their value? I would think it would be a very interesting assessment of capability and value. I realise being collegiate is one thing, being of value is another, being both is what we should have."

Comment

What has been uncovered in these interviews is that participants are reacting to what they perceive as a rather narrow concept of Board diversity. What was conveyed was a far broader concept of Board diversity than anything offered in the academic literature. While academics have focused on demographic aspects of Board diversity, actual Directors focus more on balancing the "soft" skills of Directors. Things like industry experience, cultural perspectives, and styles of interaction are more important to company Directors when they think of characteristics of Boards and Board members. This mindset was reflected in the broader range of dimensions identified by the Directors interviewed here when the topic of diversity was introduced to the discussion.

Similarly the traditional and conservative list of competencies that have been the mainstay of Director competencies on Boards is perhaps constraining thinking with respect to growth. Particularly challenging was the view not only that accounting, legal, compliance and to a lesser degree risk were over represented but that some participants believed that for accounting and legal at least, that they could be brought in when required. That is they were not essential to have on the Board – they could be as per the common management term – outsourced or bought in! Even the contemplation of this, is a real lateral thought and maybe a future predictor of where Board membership and competencies may go.

However what was made very clear was the base competency required for Directors was a good all round business person and what was being looked for in terms of diversity was in addition to this.

Thus the list of competencies on Boards needs to be broadened and diversity on Boards should be viewed with a far broader lens than has been used traditionally – also a lens where it is not diversity for diversity's sake, whatever the diversity parameter, but diversity for growth's sake.

This diversity for diversity's sake did appear to be a point of debate. The conversations about getting diversity of thought and new ideas into the Board came through, but rarely hard edged or outcome focussed, in the sense of *“we have diversity in our Board to assist us to drive growth.”* There was one rare exception that probably captures succinctly this need and the questions that need to be asked:

“One question that has to be asked is what this diversity is bringing to the Board and the growth agenda. A simple question may be, have you asked the Chief Executives who, day in and day out run the company and face the shareholders and analysts what value they actually get from the Board, before we go down the path of trying to ensure we have diversity. I would not be surprised if numerous Chief Executives would probably answer that they receive little insight outside of (rubber stamping) from the Board.”



“The first method for estimating the intelligence of a ruler is to look at the men he has around him”

Niccolo Machiavelli