

Is There a Positive Link Between Corporate Governance and Board Diversity? Lessons from Asia

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Abstract

One of the long term research questions for the multi-disciplinary study of corporate governance, has been the link between good governance and share price or other measures of value. This has been quite difficult to establish in either the legal or finance or management disciplines, but there appears to be clear evidence of corporate sustainability where quality governance practices are applied consistently. Isolating out individual factors, such as board structures, specific cultures and corporate policies, has been particularly difficult as there are so many permutations. There currently exists a significant volume of global research on the role of gender, as a part of the board composition and there are positive returns, with some caveats. This paper begins to examine and question as to whether there are positive links to a broader concept of board diversity, including gender, age and ethnicity. There have been a number of developments across Asia, including Japan, China, Singapore and Hong Kong, which provide a different paradigm from the traditional Australian comparisons with United Kingdom, America and even Europe. The hardest question is whether we should have targets or mandatory quotas.

Introduction

The last twenty years have seen various theories on corporate governance, from a wide variety of disciplines. Corporate governance has been measured by financial returns, sustainability (longevity), corporate social responsibility (CSR), board structures and their composition. Thus, mandating a particular board composition with specific types of directors is controversial. Pressure from overseas countries initiatives, stakeholders, governments, stock exchanges and human rights advocates, are demanding change. Globally the gender debate has been central to research and composition focus, but the actual diversity of board membership goes far beyond just the issue of a director's gender.

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This paper will look at whether there is a positive link between corporate governance and board diversity and lessons to be learned from Asia. Gender is a key aspect of diversity, but other attributes, such as race with cultural heritage (expressed as “ethnicity”), education, professional backgrounds and age are critical factors in boards' composition. It is the right time for boards to start to look at diversity as a

holistic issue and prioritise the inclusion of members from different national origins, socioeconomic groups, educational backgrounds, variety of ages and gender. Successful companies demonstrating the many benefits of having a diverse board of directors will be the best proof of success.

Currently diversity with reference to gender is being promoted in Europe through mandatory measures. Germany recently passed a law that requires some of Europe's biggest companies to give 30 percent of supervisory seats to women commencing 2016¹. In passing the law, Germany joined a trend in Europe to accomplish what has not happened organically, but to legislate a greater role for women in boardrooms.

However, other countries such as Australia and the UK have taken an anti-quota approach. The "30% Club" is becoming an international, business-led approach focused on developing a pipeline of senior female talent. It is complementary to individual company efforts and existing networking groups – adding to these through collaboration and the visible commitment of senior business leaders.²

The lack of gender diversity on boards has received the most attention because of the discrepancy of women who are graduates, employees and customers and their limited representation in key decision-making roles within companies. The Stock Exchange of Hong Kong, made it clear that diversity includes gender, age, cultural/educational background, and professional experience.³

The 2015 Korn Ferry study of boardrooms at the top 100 companies based on market value in 10 major Asian economies, including Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, Singapore and South Korea, found a need for boards to make strategic talent decisions in ensuring parity in gender, age and educational attainment as boards continue to be dominated by senior male executives.⁴

Corporate governance

Commentators often speak of corporate governance as an indefinable term, something akin to love, joy or even happiness, which we essentially know the nature of, but for which words do not provide an accurate picture. The Australian Securities Exchange (ASX) Corporate Governance Council Principles (2014) attempt to define,⁵ as did Justice Neville Owen as the Royal Commissioner in HIH Insurance collapse investigation. In the Final Report of the Royal Commission set up to investigate the collapse of HIH Insurance Ltd, stated:

¹ Alison Smale and Claire Cain Miller, 'Germany Sets Gender Quota in Boardrooms', *New York Times* (online), 6 March 2015 <http://www.nytimes.com/2015/03/07/world/europe/german-law-requires-more-women-on-corporate-boards.html?_r=0>

² 30 Percent Club, (31 March 2015) <http://30percentclub.org/wp-content/uploads/2015/03/About30pcClub2.pdf>.

³ Korn Ferry Institute, *The Diversity Scorecard 2013: Measuring Board Composition in Asia Pacific* (2013) 17 <<http://www.kornferryinstitute.com/reports-insights/diversity-scorecard-2013-measuring-board-composition-asia-pacific>>.

⁴ Korn Ferry, *Diversity Matters: Adding Colour to Boards in APAC* (2015) 3

⁵ Australian Securities Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations*, (3rd edition, 2014) Australian Stock Exchange, .

“Corporate governance – as properly understood – describes the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations.”⁶

We may not all agree with the precise construction of the definition of corporate governance, but just like the world of “art”, we all recognise it when we see it. A much more significant and deeper question is **what are the benefits of good corporate governance practices?**

Benefits of good governance

The bigger issue is demonstrating that there are actual benefits to good corporate governance.⁷ There is overwhelming corroborative and empirical evidence as to the impact of sustainability in governance, such as Klettner, Clarke & Adams (2010)⁸ in the report on the implementation of the ASX Corporate Governance Principles between 2003 and 2007. Professor Adams (2012) stated “There are numerous studies as to the benefits of corporate governance for global entities, whether they are transnational corporations or the more traditional multinational companies. Around the globe, by far the majority of business entities are privately owned (and/or family businesses) with a small percentage being quoted on a local stock exchange, in a single legal jurisdiction.”⁹

Impressive data was produced by Professors Claessens and Yurtoglu (2012)¹⁰ which examined the corporate governance literature over the last decade from economics, finance, management and legal scholarship in many countries and jurisdictions. Their amazingly detailed survey of literature provides evidence of the importance of corporate governance at a number of economic points. Clear evidence is provided for a link between economic development and corporate governance based on the extensive studies.

The extensive cross-country research demonstrates financial development. Examples of sophisticated and quality banking systems, is a powerful determiner of sound economic growth. Weak corporate governance can be seen to prevail in financial markets that tend to function poorly by global standards. Poor governance increases market volatility and lack of transparency creating the effect of unfair markets. Countries and companies adopting best practices in corporate governance are not guaranteed success, but provide evidence of a clear move towards sustainability and establishing long-term success.

⁶ The HIH Royal Commission Report, ‘Reasons for the failure: A broad perspective, National Capital Printing, Canberra, 2003, 101.

⁷ Michael Head, Scott Mann, Simon Kozlina, ‘Transnational Governance: Emerging Models of Global Legal Regulation, (2012) *Ashgate* and Anona Armstrong, ‘Corporate Governance Standards: Intangibles and Their Intangible Value’ (2004) 17 (1) *Australian Journal of Corporate Law* 97 cited in Michael Adams, ‘Global Trends in Corporate Governance’ (2012) 64 (9) *Keeping Good Companies* 516.

⁸ Alice Klettner, Thomas Clarke and Michael Adams, ‘Corporate governance reform: an empirical study of the changing roles and responsibilities of Australian boards and directors’ (2010) 24(2) *Australian Journal of Corporate Law* 148.

⁹ Michael Adams, ‘Global trends in corporate governance’ (2012) *Keeping Good Companies* 516, 516.

¹⁰ Stijn Claessens & Burcin Yurtoglu ‘Focus 10: Corporate Governance and Development – an update’, Global Corporate Governance Forum, 2012 <<http://www.ifc.org/?>>

Diversity within board structures and composition

The actual board structure (number of directors vary from three to a maximum on the board, plus the role of board committees, such as audit, nominations, risk etc) and the board composition (the skill and competency set expected to be an effective board) are quite distinct concepts. Most Anglo-American based companies will have a unitary board – that is a single board of directors who oversees the management of the company. The European traditions like Germany and France have adopted a bilateral board structure, with a distinct advisory board and representative board with employees elected to specific roles. The focus on unitary boards and their size (average is 8.4 with a normal distribution between 8 to 12 members is the most common)¹¹ has been examined in depth.

Board composition is who actually makes up the board of directors and will vary depending upon factors. These include accepted research by McIntyre (2011) published in *Tomorrow's boards* by the Australian Institute of Company Directors a list of competencies a board member should have, including strategic expertise; accounting/finance; legal; managing risk; managing people; familiarity with financial markets and industry knowledge. The following personal qualities are listed for a successful person to have integrity; business acumen; curiosity; courage; interpersonal skills; genuine interest and be an active contributor. Board effectiveness can be improved by a boardroom culture of mutual respect, honesty and openness that encourages constructive debate and a diversity of experience, styles, age, gender and cultural backgrounds.¹²

Galacho suggests that boards are being urged to look beyond gender diversity and seek specific skills needed for future markets survival. “There is a strong call for directors with experience in capital markets, risk management and information technology and cyber security. Any broadening of the search criteria and greater scrutiny by nominations committees and shareholders is usually good news for women seeking board roles.”¹³

The need for diversity in specific skills is emerging when board appointments are considered to enable companies to keep up with future markets and the change required to survive. Birmingham suggests that for company directors, change is the new main game and digital skills in particular are being sought during board appointments. “For board appointments, it is now the norm for clients to want to see at least some element of digital on their CV. In the beginning, ‘digital experience’ was a rather wide-reaching term, and involved anything from successfully setting up online commerce through to rolling out the technical underpinnings of online. Nowadays the digital experience required at board level is very much focused on business transformation.”¹⁴

¹¹ Korn Ferry Institute, *The Diversity Scorecard 2013: Measuring Board Composition in Asia Pacific* (2013)12 <<http://www.kornferryinstitute.com/reports-insights/diversity-scorecard-2013-measuring-board-composition-asia-pacific>>.

¹² Anthea McIntyre, *Tomorrow's boards* (AICD, 2011) 17.

¹³ Olga Galacho, ‘Boards urged to look beyond diversity’, *The Australian Financial Review* (online), 6 February 2015. <<http://www.afr.com/news/special-reports/corporate-reporting/boards-urged-to-look-beyond-diversity-20150205-141pdq>>.

¹⁴ Andrew Birmingham, ‘For company directors, change is the new main game’ *The Australian Financial Review* (online), 6 February 2015. <<http://www.afr.com/news/special-reports/corporate-reporting/for-company-directors-change-is-the-new-main-game-20150205-141pcj>>.

The make-up of the board is absolutely critical to the success of the company and the composition is impacted in terms of both gender and the broader meaning of diversity. There are a variety of definitions of what is meant by diversity of board membership.

In both studies by Kang, Cheng and Gray (2007)¹⁵ and Wang and Clift (2009),¹⁶ it was stated that “among the most significant governance issues currently faced by the modern corporation is board diversity and independence.” Similarly it was observed that “some progress but the corporate boards in United Kingdom, United States of America and Australia remain dominated by white males and the homogeneity of corporate boards may raise significant ethical, political and economic issues, while women and minorities are continuing to become a larger proportion of the workforce.” The empirical evidence provided in these studies supports an equity argument for increased diversity.

The commentary on Recommendation 1.5 of the ASX Corporate Governance Principles and Recommendations states that “It should be noted that while the focus of this Recommendation is on gender diversity, diversity has a much broader dimension and includes matters of age, disability, ethnicity, marital or family status, religious or cultural background, sexual orientation and gender identity.”¹⁷ The 2009 CAMAC Report on diversity, has a focus on gender, age and ethnicity as the major components. More explicitly in the conclusions, it stated “In relation to board diversity in Australian public listed companies, gender is just one, if one of the most obvious, of the measures of board diversity. Similar issues may arise with age, ethnicity or other measureable or less tangible aspects of differentiation.”¹⁸

Alicia Tia and Alice Tan provide a useful definition of diversity, by stating: “Diversity will be an important factor in determining future winners in Asia Pacific, one of the world’s most exciting and dynamic markets. The real question is whether boards and senior leadership are fully prepared to guide companies in this environment and to take Asia Pacific enterprises to the next level.”¹⁹ Du Plessis²⁰ suggests that ‘diversity’ at board level encompasses a number of human attributes, of which gender is but one’.

Diversity Council Australia 2014 research, has revealed ‘the bamboo ceiling’ and why so few Asian leaders are reaching boards. It has been recognised that a lack of cultural diversity is present and needs to be addressed. While 9.3% of the Australian labour force is Asian born, only 4.9% make it to senior executive level. In ASX 200 companies, only 1.9% of executives have Asian cultural origins, compared to 9.6% of the Australian community.²¹

¹⁵ Helen Kang, Mandy Cheng and Sidney Gray ‘Corporate governance and board composition: diversity and independence of Australian boards’ (2007) 15(2) *Corporate Governance* 194.

¹⁶ Yi Wang and Bob Clift ‘Is there a business case for board diversity?’ (2009) 21(2) *Pacific Accounting Review* 88.

¹⁷ Australian Securities Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations*, (3rd edition, 2014) 12.

¹⁸ Corporations and Markets Advisory Committee, *Diversity on boards of directors report*, (March 2009) 51.

<<http://www.camac.gov.au/camac/camac>>.

¹⁹ Korn Ferry Institute, *The Diversity Scorecard 2013: Measuring Board Composition in Asia Pacific* (2013) 4

<<http://www.kornferryinstitute.com/reports-insights/diversity-scorecard-2013-measuring-board-composition-asia-pacific>>

²⁰ Jean Du Plessis, James O’Sullivan and Ruth Rentschler, ‘Multiple Layers of Gender Diversity on Corporate Boards: To force or not to force?’ (2014) 19 (5) *Deakin Law Review* 1, 3.

²¹ Diversity Council Australia, *Cracking the Cultural Ceiling: Future Proofing Your Business in the Asian Century* <http://www.dca.org.au/dca-research/cracking-the-cultural-ceiling.html#sthash.PAsnIR5t.dpuf>.

Patrick Rooney reports in relation to the Diversity Council Report that “61% of Asians in Australian firms felt they needed to conform to Western leadership models. In a practical sense this means they felt they needed to be more assertive and engage in self-promotion. At the same time, they felt Asian cultural attributes related to reserve and respect for seniority were misinterpreted. Businesses need to change the measures of success and do more to actively promote diverse leadership teams.”²²

Credit Suisse 2014 report demonstrates the financial benefit of women to the company’s financial performance.²³ The Australian Council of Superannuation Investors²⁴ announced that it has launched an initiative aiming to have women comprise 30% of all boards in ASX 200 companies within the next three years. Anecdotal evidence, clearly stems from reports such as those produced by The KornFerry Institute, which quotes the Chair of Telstra Ltd, Catherine Livingstone as saying “While diversity of gender is desirable on boards, diversity of skills, experience and ideas are of equal importance”.²⁵ KPMG in 2014 provided analysis on disclosures in financial years ending between 31 December 2012 and 30 December 2013. Primary finding is that there is a need to “recognise the benefits of diversity”.²⁶

A snapshot study of board composition was conducted in January 2015 in relation to a sample of the top 100 ASX listed companies. Table 1 illustrates the average age on boards can vary from, 57 years, (Woodside Petroleum) and to 61 years (CSL Ltd). The average age does not appear to be diverse at all. In contemporary society the essential talent and skill sets, should not be limited to an over 50s club. There are many fresh, fast and progressive ideas that could be influencing ASX boards in a positive way. There are very few board members in their 40s. In relation to ethnic background the data shows there is little diversity at all. The predominant backgrounds of Australian directors on the ASX are very homogenous.

The data in Table 1 for ethnicity is based upon public information. The overall picture shows that there is remarkable uniformity on Australian boards and this can be contrasted with the jurisdictions examined in the Korn Ferry Asia-Pacific board diversity report in 2013.²⁷

International perspectives and lessons from Asia

The international experience with diversity of board membership is not as clear as one might expect. Clearly many countries have a continuing focus on gender on board membership and some countries are encouraging diversity. The evidence is mixed as to the success of any one country having a larger

²² Patrick Rooney, ‘Breaking the Bamboo Ceiling’ *Blue Steps* (online), 9 February 2015
<<https://www.bluesteps.com/blog/breaking-bamboo-ceiling>>.

²³ Credit Suisse Research Institute, ‘*The CS Gender 3000: Women in Senior Management*’ (September, 2014)
<https://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=8128F3C0-99BC-22E6-838E2A5B1E4366DF>

²⁴ Gordon Hagart, *ACSI sets 2017 goal for 30% women on boards* (5 February 2015) The Australian Council of Superannuation Investors
<http://www.acsi.org.au/images/stories/ACSIDocuments/MediaReleases/05.02.15.Media_Release.WoB_Policy.pdf>

²⁵ Korn Ferry Institute (2014) “*Beyond if not, why not: The pathway to directorship for women in leadership*”
<http://www.kornferryinstitute.com/reports-insights/beyond-if-not-why-not-pathway-directorship-women-leadership>>.

²⁶ KPMG, ASX Corporate Governance Council Principles and Recommendations on Diversity: Analysis of disclosures for financial years ended between 31 December 2012 and 30 December 2013 6.

²⁷ Korn/Ferry Institute, *The Diversity Scorecard 2013: Measuring Board Composition in Asia Pacific* (2013)
<<http://www.kornferryinstitute.com/reports-insights/diversity-scorecard-2013-measuring-board-composition-asia-pacific>>.

diversity on boards or even increasing the female directorship, except where there are mandatory quotas with consequences, if companies fail to reach those requirements. Norway, with its 40% requirement is leading the way, but other European and some Asian countries are following such a drastic approach to accelerate what should be occurring either naturally or voluntarily.

Table 1: Top 100 ASX listed companies by market capitalisation and diversity²⁸

CBA	11	3	27%	61.2	1	No 1 \$145billion
Westpac	9	4	44%	58.8	0	No 2 \$108b
BHP	14	3	21%	62.1	0	No 3 \$94b
ANZ	8	2	25%	59	1	No 4 \$91b
NAB	13	2	15%	60.3	2	No 5 \$86b
Telstra	10	3	30%	60.3	1	No 6 \$79b
Westfarmers	12	3	25%	58.8	0	No 7 \$49b
CSL Ltd	8	2	25%	61.6	0	No 8 \$42b
Woolworths	12	3	25%	61.5	1	No 9 \$40b
Woodside Pet	9	2	22%	57.6	0	No 10 \$28b
IAG	9	3	33%	57.8	1	No 20 \$15b
Computershare	7	2	28%	59.2	0	No 50 \$6.5b
Flight Centre Travel	5	1	20%	51.8	0	No 75 \$3.8b
Adelaide Brighton	6	1	17%	60.3	0	No 100 \$2.3b

Source: *SMH Top 100 Companies (30 Jan 2015) and annual reports*

The 2015 The Korn Ferry Diversity Scorecard Report²⁹ provides some valuable independent data across ten Asian countries on board membership. This was the third comprehensive study of corporate boards at the 100 largest listed companies by market capitalisation for each country. The report findings highlight that in a few countries, most notably Australia, has the highest proportion of women directors in the region and the 2013 reports concluded that Australian companies are beginning to fundamentally reshape their boards to embody a diverse set of professional experience, personal background, expertise and gender. Conversely, companies in countries such as Japan and Korea have made little progress in this area, undergoing issues that could limit their prospects when squeezed between more progressive companies in the U.S and massive players from China.

The research demonstrates that the age diversity issue appears in boards across eight Asian markets. In particular, both China and Hong Kong have the highest percentage of companies with directors from two or more generations. Whilst, Japan has the highest percentage of companies with a single generation boards, followed by South Korea. The research use labels such as baby boomers, generation X and generation Y as descriptors. It has been stated that “Australia was placed fourth out of 50 nations in Forbes’ 2012 ‘global index of employee diversity’, a study analysing various diversity elements, including gender, age, country of birth, part-time or full-time employment, education,

²⁸ Michael Adams and Grace Borsellino, ‘The unspoken reality of diversity on boards’ (2015) 67(2) *Governance Directions* 78, 79.

²⁹ Korn Ferry, *Diversity Matters: Adding Colour to Boards in APAC* (2015) 38.

income and sector. New Zealand, one of Australia's nearest neighbours in proximity and cultural values, ranked second."³⁰

Should we have targets or mandatory quotas?

Australia in relation to this question has been trying the voluntary process, there does not appear to be a lot of change. The pace has been quite glacial and slow. It may be inevitable however that Australia could very well follow what Germany has implemented with their mandatory legislative approach in order to pick up the pace in the race towards change.

Examples from the Asia Pacific region include India as the latest country to have opted for quotas to boost female representation, with a law requiring every listed company to have at least one female director within one to three years, depending on the size of the company.³¹

Australia's rate of change in female board representation has been described as 'glacial' by Blackrock³² (2013), they quote stats of 18.2% of directors of ASX200 companies are female and 41 companies have all female boards. For ASX201-300 companies the percentage falls to just 7.6% in the Board Diversity Index 2013.³³ Four years after the ASX Guidelines adopted a diversity disclosure provision, the KPMG study shows it is evident that many organisations still have a long way to go in terms of establishing clear and measurable objectives and working to improve the number of women on boards."³⁴ Many nations are now developing either mandatory diversity requirements or detailed targets over the next five years. This will see rapid change in governance, disclosures and information. In the Asia Pacific region³⁵ include in June 2011, Malaysia announced that its cabinet approved a policy that women must comprise at least 30% of decision-making positions and the Monetary Authority of Singapore in May 2012 approved a revised Code of Corporate Governance for companies listed on the Singapore Stock Exchange.

The international debate regarding the relative benefits of quotas and targets in achieving gender diversity on boards has proved hotly contested over the last decade. In major European countries mandatory quotas were adopted, while in Australia and other countries the voluntary setting of targets has been encouraged. Quotas secure substantial change through compliance, while targets may encourage change through strategic initiatives. Debates about women on boards have focused on measures designed to achieve equality of access and across countries governmental approaches may be categorised as 'hard' or 'soft'. Hard strategies involve more coercive means of achieving equality of outcomes such as legislation for affirmative action and quotas. The soft strategies involve

³⁰ Jean Du Plessis, James O'Sullivan and Ruth Rentschler, 'Multiple Layers of Gender Diversity on Corporate Boards: To Force or Not to Force?' (2014) 19(1) *Deakin Law Review* 1, 31.

³¹ Korn Ferry, *Diversity Matters: Adding Colour to Boards in APAC* (2015) 36.

³² Blackrock, Glacial change in diversity at ASX200 companies: can Australia escape the imposition of diversity quotas? *Blackrock, Australia* 2013. <https://www.wgea.gov.au/sites/default/files/BlackRock_Glacial_Change_in_Diversity_at_ASX200_companies.pdf> Accessed on 28 November 2014.

³³ See <www.womenonboards.org.au>.

³⁴ KPMG, ASX Corporate Governance Council Principles and Recommendations on Diversity: Analysis of disclosures for financial years ended between 31 December 2012 and 30 December 2013 18.

³⁵ Korn Ferry Institute, *The Diversity Scorecard 2013: Measuring Board Composition in Asia Pacific* (2013) 4 <<http://www.kornferryinstitute.com/reports-insights/diversity-scorecard-2013-measuring-board-composition-asia-pacific>>.

persuasion of market actors to achieve equality of access. The development of these strategies also involves stakeholder engagement which may be classified as coercive eg legislation for quotas; liberal which promotes voluntary actions by corporate actors, and collaborative which involves co-operation amongst stakeholders.³⁶

To resolve the low level of female participation in boards, the two most discussed forms of regulatory intervention are to set gender targets or quotas. These can be imposed as mandatory by law, with sanctions if they are not achieved, for example, Norway's quota of 40% women on boards or Germany's recent legislative approach. Alternatively, they can be softer in nature, for example the UK's recommendation of a target of 25% women on boards which has raised expectations even though adoption is formally voluntary. Both of these methods have been effective at spurring an increase in numbers although it is still too early to judge the effectiveness of the UK's voluntary approach.

Conclusion

The evidence is clear; there is a need for diversity in the composition of the board of directors of listed and major public companies. The real question is whether the use of quotas or mandatory target is the way forward. The glacial pace of change for gender on boards means diversity will probably need specific regulatory intervention in the next five years for Australia.

