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BlackRock Investment Stewardship's approach to engagement on board diversity

BlackRock has an extensive program to promote leading corporate governance practices at the companies in which we invest, as part of fulfilling our fiduciary duty to protect and enhance the value of our clients' assets. One of the most important means of improving governance is through board diversity. As Larry Fink recently wrote in his annual letter to CEOs:

> *We also will continue to emphasize the importance of a diverse board. Boards with a diverse mix of genders, ethnicities, career experiences, and ways of thinking have, as a result, a more diverse and aware mindset. They are less likely to succumb to groupthink or miss new threats to a company's business model. And they are better able to identify opportunities that promote long-term growth.*

In keeping with this mission, the BlackRock Investment Stewardship (BIS) team has for several years discussed board diversity as an investment issue with a significant number of companies in which we invest on behalf of our clients.

This note sets out in some detail our thinking on board diversity and explains how we approach engagement on the topic.

Why board diversity is an investment issue

Corporate boards are, first and foremost, decision-making bodies. As such, board composition and diversity matter. Companies succeed (or fail) over time because of their people, and people in leadership positions have an outsized impact on long-term corporate performance.

For example, diverse groups have been demonstrated in academic research[i] to deliver better decisions. Such groups tend to believe they could have taken even better decisions, probably because the more complex and at times difficult decision making process makes participants even more aware of the multiple alternatives. It isn't surprising that considering a problem from different angles, with different perspectives on risk, and from different sets of presumptions will lead to a well-considered solution.

BIS focuses on board quality and effectiveness because high performing boards ensure strong management, which in turn supports sustainable financial performance. Studies also show that visible diversity has a considerable positive impact on group performance[ii]. When we intrinsically know that someone is not the same as us we tend to think more carefully about their arguments and assessments, and better prepare our own. We are less likely to presume we understand their perspective, less likely to mimic their behaviors or defer to them and thus are more likely to flush out differences and weaknesses in positions. Diversity in this way not only leads to more robust discussions it leads to more resilient decisions, particularly in complex and changing environments.

The other important role that boards play, in addition to decision-making, is setting the tone at the top. A diverse board is a visible commitment to employees, customers, and other key external partners, to leadership best practice. Most companies today describe themselves as being in a war for talent. In most markets today the talent pool is not homogenous. Diverse employees who see leaders who are not of the dominant culture within the company can see an aspirational career path for themselves. In a talent-constrained labor market where the highest caliber professionals are diverse, it is essential for companies to have a demonstrable commitment to recruiting, retaining and developing top diverse talent. Visible diversity in leadership embodies that message, giving a company a competitive advantage.

BlackRock's engagement on board diversity

BlackRock is clear that diversity is a factor in quality leadership and financial performance. We are not aiming to direct the nominating process or tell companies what to do. We seek to build mutual understanding on these issues. As well as sharing our views, we want to understand the company's philosophy, policies and performance on diversity at the board level, and by extension, within senior management and the "talent pipeline". Where it is absent, we encourage disclosure by the board of its thinking, actions and progress (backed by data as relevant). Investors and others can then assess whether they believe the approach taken by a company is appropriate given its business, and the broader context in which the company operates.

In our engagements we ask probing questions about board composition and the appointment process. We expect boards to have credible responses to a range of questions that in our experience can demonstrate a robust approach to board diversity. The topics we may cover include:

- Current board composition and how it reflects the company's stated strategy, trends impacting the business and succession expectations.
- Position on diversity and how that position has evolved over time.
- Board evaluation process, including how it influences succession planning and the director appointment process.
- The board's approach to phasing director tenures.
- Potential to have a slate of only diverse candidates.
- Deliberate steps the nominating committee (or equivalent) is taking to enhance board diversity.
- Director appointment process and how those involved countered unconscious biases.
- How directors cultivate a diverse network of professional peers. The common practice of incumbent directors identifying candidates for the board from their networks is not necessarily an impediment to a diverse board if those networks are diverse.
- If recruitment consultants are used to identify candidates, how the nominating committee assessed the consultant's networks and expertise in finding and placing diverse directors, especially first time directors[iii].

BlackRock's corporate governance work has always focused on the quality of the board. We will continue to promote, and encourage commitment to, diversity in leadership more generally through our dialogue with company directors and management, sharing best practices, and contributing to the public debate, as appropriate. As we set out in our voting policies, following engagement and a reasonable time for the company to respond, we are likely to vote against directors on boards that don't make progress on diversity without a specific and credible explanation. Deliberate action needs to be taken by boards with a lack of diversity. A new mindset may also be necessary in some companies, particularly to accept that board diversity is a performance imperative in today's dynamic corporate boardroom and workforce.

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[i] http://insight.kellogg.northwestern.edu/article/better_decisions_through_diversity

[ii] Levine, S. & Zajac, E. The Institutional Nature of Price Bubbles (2007) and Levine et al, Ethnic diversity deflates price bubbles (2014) in Proceedings of the National Academy of Sciences (US)

[iii] Spencer Stuart's 2017U.S. Board Index (of S&P500 companies) reports that of the 397 new independent directors appointed in 2017, 45% are serving on their first public company board and more than half are women or minorities (up from 37% in 2016)