

# Vanguard Investment Stewardship Insights

## A continued call for boardroom diversity

*Vanguard publishes Investment Stewardship Insights to promote good corporate governance practices and to provide public companies with our perspectives on important governance topics and issues that come up for shareholder votes.*



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Vanguard has long advocated for diversity of experience, personal background, and expertise in the boardroom. Diverse groups make better decisions, and better decisions can lead to better results for shareholders over the long term.<sup>1</sup> In 2017, we were a leader in advocating for gender diversity on boards. In 2019, we made more explicit our view that diversity includes not just gender but also other personal characteristics such as race, ethnicity, national origin, and age. We have also encouraged boards to publish their perspectives on diversity, to disclose board diversity measures, and to cultivate diverse pools of candidates for open director seats.

Boardroom diversity will continue to be a focus of Vanguard's stewardship activities in 2021 and beyond. While we have seen progress, we recognize that some companies may be in the early stages of developing and implementing a boardroom diversity strategy. There are also regional differences to take into account, and in some cases country-specific regulations that

create unique situations for diversity data disclosure. But when we see a lack of commitment to progress on diversity—for example, a board lacking any gender diversity or any racial or ethnic diversity—we become concerned that long-term shareholder returns may suffer.

Beginning at 2021 annual meetings, the Vanguard funds may vote against directors at companies where progress on board diversity falls behind market norms and expectations.<sup>2</sup> In such cases, we may hold nominating committee chairs or other relevant directors accountable. We will continue to advocate for changes that reflect our view that well-composed boards are in the best interest of long-term shareholders.

We don't advocate for one-size-fits-all mandates. Our due-diligence process is flexible and evaluates companies case by case. That's why we routinely emphasize the importance of concise, clear disclosures to help a company's shareholders understand its board diversity strategy and progress.

<sup>1</sup> Hewlett, Sylvia Ann, Melinda Marshall, and Laura Sherbin, December 2013. How Diversity Can Drive Innovation. *Harvard Business Review*.

<sup>2</sup> We anticipate that the greatest board diversity risks to the portfolio in 2021 will be companies with 0% board gender diversity, 0% board racial or ethnic diversity, or a lack of board diversity disclosure and policy. At this time, we are focused on North America and Europe, where we believe that the risks (driven by regulation or other stakeholder pressures) are greatest. We will continue to assess other opportunities for progress—including in additional markets—case by case.

## Our expectations on board diversity

In 2019, Vanguard called for boards to achieve greater diversity. In 2020, we provide further clarity for boards to make progress as the funds' expectations in the area continue to evolve.

### 2019

#### **Publish your perspectives on board diversity.**

Here's what we ask companies: Does your board share its policies or perspectives on diversity? How do you approach board evolution? What steps do you take to get the widest range of perspectives and avoid groupthink? Vanguard and other investors want to know.

#### **Disclose your board diversity measures.**

We want companies to disclose the diversity makeup of their boards on dimensions such as gender, age, race, ethnicity, and national origin, at least on an aggregate basis.

#### **Broaden your search for director candidates.**

We encourage boards to look beyond traditional candidate pools—those with CEO-level experience—and purposely consider candidates who bring diverse perspectives into the boardroom.

#### **Make progress on this front.**

Vanguard expects companies to make significant progress on boardroom diversity across multiple dimensions and to prioritize adding diverse voices to their boards in the next few years.

### 2020

#### **Step up board diversity efforts.**

We expect boards to publish their perspectives on board diversity, disclose their diversity measures, interview diverse pools of director candidates, and reflect a range of diversity.

#### **Invest in a prospective-director pipeline.**

We expect boards to identify director candidates now. To avoid disruption, boards should develop relationships with executives who lead finance, technology, human resources, marketing, accounting, audit, or investment functions. When the time comes, these executives can bring valuable subject matter expertise to boards.

#### **Make progress and show outcomes.**

We expect tangible outcomes such as formerly homogeneous boards becoming increasingly diverse and better reflecting the employee and customer composition of the companies they help lead. We may vote against certain directors when we see a lack of progress.

## Considerations for boards looking to make progress

**Long-term planning.** Boards should have a long-term plan for how they intend to add diverse voices to their ranks. Our research—along with the countless discussions we've had with directors, nominating committee chairs, industry groups, and executive search firms—has made clear that progress on diversity requires both near-term action and long-term commitment. Board recruitment should not just start when a director resigns from a board or announces his or her retirement. As boards anticipate how company strategy and risks may change over the coming years, they should identify, meet with, and build a deep bench of potential candidates who possess the requisite experience and perspective. This advance planning and relationship-building can speed the director search process and minimize boardroom disruption when a board seat opens up.

**Broad searches.** We encourage boards to look beyond the corner office for new director candidates. Sitting or former CEOs are often popular choices for board seats, but executives who lead finance, technology, human resources, marketing, accounting, audit, or investment functions, among others, can bring deep and valuable subject matter expertise to boards. These broader searches can identify candidates with diversity of experience and of personal characteristics.

**Strategic increases to board size.** Boards should consider deliberately expanding in service of greater diversity. Competition for directors can be fierce, and companies should act opportunistically when they identify highly qualified diverse candidates. We would expect a board to readjust its size as appropriate at a later time.

**Board cultures that foster difference and debate.** A boardroom diversity strategy doesn't stop once diverse directors have been identified. As with any high-performing team, a board's culture matters. The board chair, lead director, and executive management team should drive an inclusive onboarding process, invite new director participation, and encourage differences of opinion. Boards will not realize the benefits of diversity if boardroom culture resists change.

### What we look to understand about boardroom diversity

The information that a company provides through disclosure and engagement helps us understand its approach to diversity. We assess companies in the context of Vanguard's understanding of best practices, evolving market norms, and the materiality of risks to given industry sectors and companies, all of which inform the proxy votes cast by our funds.

We engage both with companies leading the way on diversity and with those that lag their peers. Below are some typical questions we might ask directors during an engagement. We share them here in the spirit of disclosure, and in the hope that boards and leadership teams may find them useful, even if they are not engaging with our team.

- How do directors define board diversity? What role does diversity play in the company's overall talent strategy? What are the risks and opportunities?

- How often does the board conduct a board skills assessment? Are diverse characteristics incorporated into your process?
- How does the board apply diversity considerations to its search for new directors?
- Has the board faced any challenges when seeking to increase board diversity?
- What tactics has the board considered to increase its diversity? Have you considered expanding the board? Looking beyond CEO-level candidates? Planning further ahead?
- Has the board considered partnering with external search organizations focused on identifying diverse talent?
- How has the board evaluated its onboarding process to ensure that future diverse board members are properly integrated into and included in the board's activities?

We want to hear from boards on how they have prioritized diversity. That feedback enables us to understand a board's grasp of its diversity risks and opportunities, and where the company is on its journey toward improved board composition.