



Promoting Board Diversity *A Role for Investors*

Nearly 25 years ago, our client, Sisters of Notre Dame de Namur, shared an innovative idea with Walden Asset Management (Walden). At that time, investors routinely voted company proxies in support of director nominees. The Sisters made a compelling argument that board diversity was both a social justice and business imperative. When women or racial minorities were not represented on corporate boards, they saw no reason to vote for directors who were responsible for nominating new candidates.

Walden agreed with the Sisters. We embraced their approach in our own proxy voting policies—we believe the first investment manager to do so. What's more, right from the outset we communicated our voting rationale to companies. Some immediately listened and acted. In 1994, the Chairman of Echo Bay Mines notified Walden that it had added its first woman director, stating that: "your activism for a good cause was a significant stimulus to get us to move. Echo Bay will be a better company for it."

THE CHALLENGE CONTINUES

Decades later, women remain significantly underrepresented among corporate directors despite modest advances in recent years. Women held just 16 percent of S&P 1500 company board seats in 2014 and nearly one-in-five corporate boards have no female representation at all (ISS 2015 Board Study: United States). These numbers are particularly disappointing since women make up nearly half of the U.S. workforce (47 percent in 2013). They are attaining educational credentials at record levels; U.S. Census Bureau data shows women now account for about six of ten advanced degree holders among the 26-29 year age group. Similarly, while people of color account for 38 percent of the U.S. population, they held just 10 percent of S&P 1500 directorships and over 40 percent of the companies had no minority representation (ISS 2015 Board Study: United States).

THE BUSINESS CASE

Walden believes that diversity, inclusive of gender and race, is a critical attribute of a well-functioning board and a measure of sound corporate governance. Hence, we pursue a multi-faceted strategy of shareholder engagement and public policy advocacy to encourage greater representation of women and racial minorities on corporate boards and in senior

management. The foundation of this work is our conviction that there is a strong business case for board diversity as described below:

Research confirms the business rationale for diversity on corporate boards. For example, the August 2012 Credit-Suisse Research Report *Gender Diversity and Corporate Performance* correlates board diversity to better financial and stock market performance (higher return on equity, lower leverage, improved growth prospects, and higher price/book ratios). It suggests several explanations for these better results including a stronger mix of leadership skills, improved understanding of consumer preferences (women control more than two-thirds of U.S. consumer spending), a larger candidate pool from which to pick top talent, and more attention to risk. In 2014, Credit-Suisse updated its research and observed similar results. Additionally, numerous studies suggest a critical mass of at least three women directors strengthens corporate governance.

Institutional investors are increasingly becoming strong advocates for progress. An October 2014 PwC survey of investors representing more than \$11 trillion in assets observed that "Nine out of 10 investors believe boards should be revisiting their director diversity policies, and 85 percent believe doing so will require addressing underlying impediments..." With a representative of CalSTRS (California State Teachers Retirement System), Walden's Tim Smith co-chairs the Investor Committee of the Thirty Percent Coalition—a network of corporate governance experts, corporations, senior business executives, state-wide elected officials, national women's organizations, and institutional investors—which aims to encourage gender diversity in boardrooms through outreach to companies and other initiatives. Signatories to recent letters to companies lacking women directors have included the Comptrollers of New York State and New York City; the Treasurers of the States of Connecticut, Maryland, Massachusetts, Pennsylvania, Washington State, and California; representatives of CalSTRS, CalPERS and AFL-CIO; and various foundations, religious investors, mutual funds, and investment managers.

Business leaders are themselves more vocal on the benefits of greater gender balance in senior leadership. In 2014, a U.S. chapter of the U.K.-based 30% Club was launched to promote

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board and senior management diversity. Among its members are Founding Chairman Peter Grauer of Bloomberg, Warren Buffet, Larry Fink of BlackRock, and Sheryl Sandberg of Facebook. They publicly champion their belief that increasing the representation of women in corporate leadership roles is good for business and good for the economy.

Investment firms are responding to growing interest by directing capital to higher performing companies. In 2014, U.K.-based Barclays launched an exchange-traded note based on an index of companies with female CEOs or directors (the latter with a threshold of 25 percent). In the U.S., Bank of America and Morgan Stanley have similarly expanded their product offerings.

The global regulatory and legislative context puts additional pressure on voluntary initiatives in the U.S. to produce results. Regulations and legislation with various quantitative mandates and timetables to increase gender diversity on boards in countries such as Belgium, France, Germany, Italy, Norway, and Spain are rapidly changing the complexion of directors in those locations. A European Commission directive setting a board quota of 40-percent by 2020 for the under-represented gender is currently pending approval, and, among others, non-quota governance rules in Australia and Japan are also underway. U.S. firms seeking to avoid similar movement toward quotas will need to show that voluntary efforts can successfully increase diverse representation on boards.

UTILIZING SHAREHOLDER LEVERAGE TO ENCOURAGE BOARD DIVERSITY

Through dialogues, shareholder resolutions, and proxy voting communications, Walden asks portfolio companies to foster greater board diversity over time by:

- Strengthening Nominating and Corporate Governance policies and charters to explicitly embed a commitment to diversity inclusive of gender, race, and ethnicity in Board searches;
- Committing to include women and minority candidates in the pool from which Board nominees are chosen; and
- Providing an annual assessment of challenges experienced and progress achieved.

Following engagement by Walden and our partners, numerous portfolio companies have added women and minority directors, amended corporate governance policies to explicitly recognize gender and racial diversity as a factor in the selection of directors, and committed to develop a diverse director candidate pool.

Walden's multi-year engagement with technology company NetApp provides a case in point. After first raising concerns with company management in 2012, NetApp agreed in early 2013 to expand disclosure in its proxy statement that described the value of gender and racial diversity on the board as well as specific steps it could take to build a diverse candidate pool. The following August, a woman was nominated and elected to the company's board.

Simultaneously, Walden often seeks greater disclosure of equal employment opportunity (EEO) data on workforce composition as well as reporting on company successes and challenges in hiring and promoting women and minorities to senior management positions. Such disclosure brings increased public accountability that is undoubtedly an impetus for progress. Plus, every new woman or person of color in a senior executive role is a potential director candidate, or two, down the road.

Forces from a variety of venues are coalescing to bring greater attention to the relatively low level of gender and racial diversity in U.S. corporate boardrooms. Walden believes the business case for improvement is clear. While progress is slow and uneven, we find ample reason for optimism.



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