Bringing Diversity to the Boardroom: Connecticut's Unique Partnership

by Connecticut State Treasurer Denise L. Nappier

As the corporate scandals of the past year reverberated through the portfolios of institutional investors and individual shareholders, our global economy was shaken and our confidence in the markets rattled virtually to its core.

The shockwaves have yet to abate, and as we work to regain our collective footing, it is in everyone's best interest to view the disruption broadly rather than narrowly, and absorb lessons that can strengthen our economic system for the long-term as we restore confidence in the short term.

To do so, we must do more than simply return to the old rules and long-held practices that seemed to serve us well. In the long run, they didn't. If confidence is to be restored and our economic foundation strengthened, we need to conduct business differently.

We must seize opportunity from the depths of economic downturn – thereby averting a greater disaster and establishing the structure upon which future growth, vibrancy and vitality can be built.

Fortunately, recognition of the imperative for change is growing, and we are seeing the beginnings of a very different approach in corporate America to the responsibilities and obligations of corporations and their boards of directors. This new approach is characterized by more strident and stringent regulatory, legislative and administrative requirements across the breadth of corporate governance reforms and intensified interest in these issues by an impressive array of institutional and individual investors.

These efforts, by Connecticut and other institutional investors in particular, have both drawn attention and brought results, in some cases moving major companies to step into previously uncharted territory, providing a model for others to follow.

The concerns about corporate governance are not new, it is the corporate interest in addressing them that marks a new day.

For the Connecticut Retirement Plans and Trust Funds, these issues have been central to our efforts for some time. Our proxy voting guidelines, the most far-reaching in the history of our fund, were established early in my administration, prior to the revelations of corporate scandals.

Working closely with our Investment Advisory Council, we developed an overarching framework of policy guidelines for our proxy votes (previously, proxy votes had been left to the varying discretion of individual managers). The guidelines became the basis for our actions advocating shareholder rights and corporate accountability, in an effort to maximize long-term shareholder value.

PROMOTING DIALOGUE ON GOVERNANCE ISSUES

For the past three years, in dozens of shareholder resolutions on a multitude of issues, we have sought ways to work with other institutional investors and the companies in which we invest to increase the independence of boards and their responsiveness to shareholders. We have initiated serious dialogue on issues ranging from the separation of audit and consulting work by accounting firms to the relationship between executive compensation and company performance, from the need for companies to inform shareholders about steps being taken to minimize risks associated with global warming to the importance of adequate safeguards for workers. These efforts have been marked by incremental progress and solid success, and they continue in the current proxy season.

Among the issues we have been advocating is the importance of increasing diversity in the boardroom to better reflect a company's workforce, customers and community. Such a policy is ultimately in the best interest of shareholders and our economy. Diversity around the director's table creates a culture in which members question policies and plans and hold each other accountable for decisions that are made. Board diversity also benefits the decision making process because members are drawn from the broadest pool of talent and experience and reflect the diverse needs of the communities in which companies do business.

On this issue, the CRPTF has filed shareholder resolutions to increase board diversity at EMC, American Power Conversion, and Bed-Bath & Beyond. Since those filings, EMC and Bed, Bath & Beyond have added women to their boards. This year, the CRPTF filed a shareholder resolution to link executive compensation to CEO and senior management diversity goals at Johnson & Johnson. That resolution was recently withdrawn after negotiations with the company were successfully concluded, with Johnson & Johnson agreeing to include this practice in the compensation committee charter. Also this year, we filed a resolution with Illinois Tool Works to request that the company, on its web site, report on workforce diversity and compliance with Equal Employment Opportunity Commission (EEOC) guidelines. The company recently agreed to this proposal.

These actions – and numerous others -- on the full range of corporate governance issues are well founded, entirely necessary, and, I believe, only the early steps on the road towards achieving restoration of consumer and investor confidence.

UNPRECEDENTED OPPORTUITY FOR CORPORATIONS

One innovative response, specifically related to the independence and diversity of board members, provides an unprecedented opportunity on many fronts. It is an opportunity that Connecticut is aggressively pursuing.

Late last year, in response to the corporate financial scandals, the New York Stock Exchange and the National Association of Securities Dealers (NASDAQ) established new standards requiring that independent directors comprise a majority of most corporate boards. The plans are awaiting formal approval by the U.S. Securities and Exchange Commission (SEC) and would give companies two years to comply.

These new standards will require listed companies to add a substantial number of new, independent members. Potentially, this new standard will mean the addition of hundreds of people who have never served on corporate boards. The NYSE rules also require independent compensation, nominating and audit committees, and Nasdaq's rules also increase the independence requirements for directors with oversight in these areas.

There can be little doubt that, with some effort and the encouragement of these tougher standards, our nation's corporations can do better. There is a real chance, as never before, to add diversity to the boardroom and new strength to the bottom line.

In fact, several academic studies have clearly shown that companies with diverse boards and diverse upper management perform better than companies that don't.

One study, conducted in 2002 study at Oklahoma State University, examined the relationship between board diversity and firm value for *Fortune 1000* firms excluding utilities and financial services firms. After controlling for size, industry, and other corporate governance measures, the study found significant positive relationships between the number of minority board members appointed and firm value.

Beyond the academic studies, a Blue Ribbon Commission of the National Association of Corporate Directors (NACD) recently recommended that boards "seriously consider...the distinctive skills, perspectives and experiences that candidates diverse in gender, ethnic background, geographic origin and professional experience...can bring to the boardroom."

Additionally, several prominent groups are now encouraging boards to assess their composition with respect to diversity. TIAA-CREF, the Council of Institutional Investors (CII) and the California Public Employees' Retirement System (CalPERS) all reference board diversity in their corporate governance guidelines.

INDEPENDENT, DIVERSE CORPORATE BOARDS

Yet, despite the studies, the recommendations, and the growing interest in diversity and the bottom line, a recent survey of the top 1500 companies showed that the percentage of minorities holding board seats is only 8%. For women, it's not much better, about 9%.

Fewer than 10 women and minorities among the *Fortune* 500 are chief executive officers—historically a common criterion for board membership. In addition, white men still hold the vast majority of senior management jobs; women corporate officers represented only 15.7 percent of all corporate officers in the *Fortune* 500 (up from 12.5% in 2000), according to the *2002 Catalyst Census of Women Corporate Officers and Top Earners.*

Catalyst identified 13,673 corporate officers in the *Fortune 500*, with 2,140 being women. The survey also found that nonwhite women have an exceptionally difficult time climbing the corporate ladder. Nonwhite women accounted for only 1.6 percent of the corporate officers at participating companies, compared with 1.3 percent two years ago. Sheila W. Wellington, president of Catalyst, has described these numbers as "virtually stagnant and minuscule."

In 2001, the State of Connecticut's Permanent Commission on the Status of Women surveyed the top 100 companies in Connecticut and found that of the companies responding, 49% had no women members on their board.

A study by the Investor Responsibility Research Center (IRRC) last year, *Board Practices/Board Pay 2002, The Structure and Compensation of Boards of Directors at S&P 500 Companies*, found that 85 percent of those companies studied had at least majority of independent directors but that only 48 percent had boards that were two-thirds independent – the threshold encouraged the Conference Board, the Business Roundtable, and many corporate governance activists.

The IRRC study also found that only 74 percent of the S&P 500 companies had nominating committees, and only 50 percent of those committees were fully independent, underscoring the need for a dramatic influx of independent members if companies are to comply with the new standards.

I believe it is in everyone's interest to cultivate a new crop of independent directors that will also bring greater diversity to corporate boards. That is why Connecticut Treasury is pulling together a dynamic coalition to help make that happen.

CONNECTICUT'S BOARD DIVERSITY INITIATIVE

We've developed a Board Diversity Initiative – the first time to my knowledge that's been done anywhere in the country. It's charter members include organizations that don't often sit at the same table, and rarely pull in the same direction on the issue of diversity – increasing the number of women, African-Americans, Latinos and other minorities -- on corporate boards.

Significantly, our initiative includes Connecticut's leading business member organizations, the Connecticut Business and Industry Association (CBIA) and the Southeastern Area Commerce and Industry Association (SACIA), as well as the Connecticut Technology Council and the National Association of Corporate Directors Connecticut River Valley Chapter. Together, they speak for thousands of business in our State, large and small -- businesses that run the gamut from small manufacturers to Fortune 500 leaders. The initiative also includes the enthusiastic participation of various state commissions whose mission is about promoting women and minority affairs, as well as a number of local and national community-based and civic organizations including the National Conference on Community and Justice.

This innovative initiative will, among other things, get the word out to companies about the importance of diversity, help inform individuals about what it takes to serve on boards and how they can identify opportunities to serve, work with companies that currently lack diverse board memberships, and broaden the talent pools of participating organizations to further this effort.

The executive vice president of the CBIA, John Rathgeber, has said the organization signed on to the effort because "Our members understand that diversity on their board of directors strengthens their corporations and enhances their ability to achieve strategic goals."

This Board Diversity Initiative will utilize the talent banks of the state commissions and also outreach to professional organizations through the initiative's business partners. As it unfolds, specific strategies will be developed to market to companies the existence of pools of well qualified potential board members and to potential board members the vast range of corporate boards that will be searching for new members.

This effort could, and should, be echoed in other jurisdictions, and serve as a means of bringing to corporate decision making a broader and more effective representation of the interest of shareholders, and a greater responsiveness to the workforce, community and customers.

With cooperative efforts like the Board Diversity Initiative, and with continued preparation, perseverance and persistence, we can and will expand opportunity as we restore public and investor confidence. Such a result could well be the silver lining in the storm clouds that have been hovering over our economy since the unraveling of the corporate scandals at Enron, WorldCom, Tyco, and the like.

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