

SUBMISSION FOR THE CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS, 4TH EDITION

Ms. Mavis Tan,
ASX Corporate Governance Council
PO Box H224 AUSTRALIA SQUARE NSW 1215

27 July 2018

Dear Mavis and members of the Council,

I write to participate in the consultation process for the 4th edition of the ASX Corporate Governance Principles and Recommendations. As an academic and researcher who has worked on corporate governance and board gender diversity, I'm grateful to have the opportunity to make submissions regarding these aspects of the Corporate Governance Principles and Recommendations.

My submission will specifically address Recommendations 1.6 and 1.5.

In brief, my submission is as follows:

1. Recommendation 1.6

The benefits of diversity to counter 'groupthink' can be harnessed by focusing on all forms of diversity (including gender diversity), and specifically, diversity of perspectives. Diverse perspectives, along with a willingness to question management when required, are important for the board of directors to be able to effectively fulfil one of its most important functions, namely, monitoring management. One way to ensure that companies are paying attention to this on an ongoing basis is by including a consideration of these issues in the board evaluation process. Thus, I submit that Recommendation 1.6 should include a consideration of the diversity of perspectives on the board and the ability of directors, especially independent directors, to challenge management.

2. Recommendation 1.5

Board gender diversity is an important goal but not an end in itself. Gender-diverse boards are the starting point to ensure that workplaces are more equal. The Recommendations do a commendable job in stressing that a pipeline of diverse candidates needs to be built within the company, and that programs and initiatives to help achieve diversity objectives are necessary. However, companies need to be encouraged further by recommending disclosures regarding the implementation and working of such programs rather than merely requiring companies to disclose their diversity policy, measurable objectives and progress in achieving the measurable objectives. In short, the emphasis should be on the efforts to make workplaces more equal rather than on numerical outcomes. I therefore submit that there should be a requirement to disclose initiatives and programs to encourage diversity (gender and other forms) and some commentary to help companies develop such programs and initiatives.

In my submission, I elaborate on the research supporting my submissions and on the position in other jurisdictions that might be helpful.

I hope my submission is helpful to your inquiry.

Kind regards,
Akshaya

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SUBMISSION TO THE ASX CORPORATE GOVERNANCE COUNCIL REGARDING THE CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS, 4TH EDITION

Prepared by **Dr. Akshaya Kamalnath**

Context

1. The recent instances of misconduct (and failure of corporate boards to detect and address such misconduct) in the financial sector involve companies that are not only compliant with the board gender diversity recommendations, but also have a higher percentage of women directors than recommended in the Corporate Governance Principles and Recommendations.¹ This is most likely because women directors in Australia seem to be from the same networks as their male colleagues. This means that they are not outsiders,² thus losing out on one of the most significant promised benefit of gender diversity (and other forms of diversity) – overcoming ‘groupthink’.³ The need to counter groupthink, and the potential of diversity to do so, has been identified in the commentary to Principle 2 in the context of the nomination committee. The general commentary to Principle 2 also discusses the need for an adequate number of independent directors ‘who can challenge management and hold them to account’. However, it is important to counter groupthink in the board as a whole to ensure effective corporate governance.
2. In a forthcoming article,⁴ I describe the mechanism by which gender diverse boards overcome groupthink and exercise independent judgement, thus improving board effectiveness:

According to empirical studies, an increase in the number of female directors is associated with an amplified discussion of ‘tough issues’.⁵ One explanation for this is that since female directors must overcome many systemic barriers to attain board positions, they tend to be highly motivated and prepared for meetings.⁶ Another explanation is that female directors, typically come from outside the groups and networks most directors belong to, and this makes them ‘outsiders’, therefore giving them a different perspective.⁷

In support of both these explanations, a study shows that women do not shy away from the ‘tough issues’ in the boardroom because of not belonging to the ‘in-group’. According to this study, since women directors have had to overcome barriers to reach board positions, they are better equipped to address difficult issues as compared to male directors who are bound by ‘loyalty norms’.⁸ The authors of this study, however, also opine that once women directors’ transition into in-group, they would also be reluctant to raise difficult issues.⁹ Thus, this would be a temporary advantage.

Also relevant here is a strand of literature draws from theories of groupthink to argue that diverse boards would be better monitors of management.¹⁰ Groupthink, in essence, is a concurrence-seeking tendency often seen in members of cohesive groups; and this tendency

¹ Both AMP and Commonwealth Bank have had at least 3 women directors since 2011. See Citi, ‘ESG: ASX100 Women on Board Analysis’ (18 August 2011) <https://30percentclub.org/wp-content/uploads/2014/08/ESG_ASX100_WomenOnBoardAnalysis.pdf>.

² Sherene Smith, “Company boards are stacked with friends of friends so how can we expect change?” (The Conversation, 4 May 2018) <<https://theconversation.com/company-boards-are-stacked-with-friends-of-friends-so-how-can-we-expect-change-95790>>.

³ Akshaya Kamalnath, ‘Gender Diversity as the Antidote to ‘Groupthink’ on Corporate Boards’, (2017) 21 Deakin Law Review 67-85.

⁴ Akshaya Kamalnath, ‘The Corporate Governance Case for Board Gender Diversity – Evidence from Delaware Cases’ Accepted for publication in (2018-19) Albany Law Review, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128272.

⁵ Nancy McInerney-Lacombe and Diana Bilimoria, *Championing the Tough Issues* (Catalyst Report on Directors and Boards, 2011).

⁶ *Id.*

⁷ Nanette Fondas, ‘Women on Boards of Directors: Gender Bias or Power Threat?’ in Ronald J. Burke & Mary C. Mattis (eds) *Women on Corporate Boards of Directors: International Challenges and Opportunities*, (Kluwer Academic Publishers, 2000) 172-173.

⁸ Nancy McInerney-Lacombe, Diana Bilimoria and Paul F. Salipante, ‘Championing the Discussion of Tough Issues: How Women Corporate Directors Contribute to Board Deliberations’, in Susan Vinnicombe et. al. (eds) *Women on Corporate Boards of Directors: International Research and Practice* (Edward Elgar Publishing Inc., 2008) 123-124.

⁹ *Ibid.*, 137.

¹⁰ *Ibid.*

fosters over-optimism, lack of vigilance and an irrational belief in the group's morality.¹¹ Groupthink results in defective decision-making by the group, even when individual members of the group are both qualified and conscientious.¹² Drawing from this, it has been argued that diversity could make boards psychologically independent of the CEO because diversity in the group will make groupthink less likely.¹³

3. The consultation draft for the 4th edition of the Corporate Governance Principles and Recommendations (Consultation Draft) addresses the issue of groupthink to some extent by recommending that the board develop a skills matrix and appoint directors accordingly (in principle 2.2) which would mean that the nomination process would focus on requisite skills rather than being influenced by familiarity and friendship; and by recognizing that close personal ties and lengthy board tenure might affect the ability of directors to function as 'independent directors' (in principle 2.3). The general commentary to Principle 2 already states that the board should have an appropriate number of independent directors who can 'challenge management and hold them to account...'. However, there is a need to link these recommendations relating to board effectiveness with those relating to board evaluation. I will address this in my comments about Recommendation 1.6.
4. Another problem with respect to gender diversity is that despite efforts in this regard, women who don't belong to existing networks still face hurdles in accessing board positions.¹⁴ To that end, the recommendations address issues like aiming for a workplace culture of inclusion (in the commentary to Recommendation 1.5) and creating a pipeline of diverse candidates by aiming at diversity at operational roles (also in commentary to Recommendation 1.5). However, a requirement to disclose details of 'programs and initiatives' to improve diversity would help attract and retain diverse candidates more than mere disclosures of numerical targets and benchmarks. I will address this in my comments about Recommendation 1.5.
5. Useful initiatives and programs proposed in the context of the American company Uber are instructive. In another forthcoming article¹⁵, I present some relevant aspects of a report issued by the Holder Committee after its investigation of allegations of harassment at Uber:

The Holder Report has a section dealing with 'enhancements' to diversity and inclusion which presents recommendations that go well beyond what the current gender diversity laws seek to achieve. In addition to publishing diversity statistics, the committee recommends that the company publish how it intends to increase diversity each year. The report also recommends that the head of diversity should publicise initiatives, accomplishments, and areas still needing improvement in this regard.¹⁶

- *Sponsorship/mentorship*

The report also suggests the adoption of a 'sponsorship' program similar to the mentorship program already promoted in Australia at the board and management levels.¹⁷ However, it suggests that this program needs to start from the mid-management level and should aim to 'positively impact pay, retention, ambition and career advancement'.¹⁸ This recommendation speaks to the problem of women and minority persons not having the required networks and role models in the workplace. To further ensure the active participation of the sponsor in the

¹¹ Irving L. Janis, *Victims of Groupthink* (Houghton Mifflin Company, 1978) 13.

¹² *Ibid.*

¹³ Erica Beecher-Monas, 'Marrying Diversity and Independence in the Boardroom: Just How Far Have You Come, Baby?' (2007) 86 (2) *Oregon Law Review* 373.

¹⁴ A similar phenomenon has been identified in Norway where a few women, known as 'golden skirts', hold multiple board positions. See Morten Huse 'The 'Golden Skirts': Lessons from Norway About Women on Corporate Boards of Directors', in Gröschl S and Takagi J (eds), *Diversity Quotas, Diverse Perspectives: The Case of Gender* (Ashgate Publishing Ltd, 2012) 16-17.

¹⁵ Akshaya Kamalnath, 'Corporate Diversity 2.0 – Lessons from Silicon Valley's Missteps' (Accepted for publication in (2018) 20(1) *Oregon Review of International Law* available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3170803.

¹⁶ *Ibid.*

¹⁷ *Ibid.* VII. F.

¹⁸ *Ibid.*

program, the Report suggests that such programs be regularly reviewed and the results be incorporated into the annual performance assessment metrics of the sponsor.¹⁹

- *Gender neutral promotion metrics*

Another recommendation in support of employee retention states that the performance review process should be fair, transparent and objective. Further, expected benchmarks should be made clear and feedback should be continuous to ensure that employees are aware of company's expectations.²⁰ Also, it recommends introducing self-nomination and peer-manager nominations to an independent committee along with a blind review process to eliminate subjectivity.²¹

- *Channels through which employees' problems can be heard*

To further ensure that specific issues that lead to employees leaving the company are identified, the Report recommends exit interviews with neutral third parties like a consultant, or human resources personnel and internal surveys to be conducted. Thus, the company can then address those issues that are identified.²²

In my submissions for Recommendation 1.5, I draw from these recommendations to propose disclosures regarding the 'programs and initiatives' mentioned under clause b (ii) of the recommendation and that guidance on such programs and initiatives be elaborated upon in the commentary.

This submission discusses the changes required for Recommendation 1.6 first because the changes I propose for Recommendation 1.5 and the commentary to Recommendation 1.5 also draw from the discussion of Recommendation 1.6.

Recommendation 1.6

6. Recommendation 1.6 in the Consultation Draft states:

A listed entity should:

- (a) have and disclose a process for evaluating the performance of the board, its committees and individual directors for each reporting period; and
- (b) disclose, for each reporting period, whether a performance evaluation was undertaken in accordance with that process.

The commentary explains that 'particular attention should be paid to addressing issues that may emerge from that review, such as the currency of a director's knowledge and skills or if a director's performance has been impacted by other commitments'. The commentary indicates that the focus of the evaluation is restricted to the skills, knowledge and commitment.

7. I submit that, particularly for independent directors, the evaluation should also consider aspects like independent thinking and ability to challenge and question management so as to be able to detect and address misconduct. While gender and other forms of diversity can act as proxies for viewpoint diversity and independent thinking, they will not always be effective ones. Thus, board evaluations in this regard would help the chair and the board as a whole self-reflect on whether they are adequately monitoring management.
8. Some aspects of the recent Malaysian Code of Corporate Governance (MCGC) are instructive in this regard. It requires companies to undertake and disclose evaluations of their boards and individual directors so as to allow stakeholders to 'form an opinion' on board effectiveness.²³ This is to be done by conducting an annual evaluation of the board as a whole, board committee

¹⁹ Ibid.

²⁰ Ibid VIII. E.

²¹ Ibid.

²² Ibid VIII IX.

²³ Malaysian Corporate Governance Code, 2017, 5.0 [28].

and individual board members. The board must then disclose how the evaluation was conducted and the outcome of the evaluation in its annual report.²⁴

9. The specific aspects specified with respect to evaluation of individual directors are all indicative of the MCGC's emphasis on ensuring that there is actual independence of thought. It states that it should include an evaluation of their:
- (i) will and ability to critically challenge and ask the right questions;
 - (ii) character and integrity in dealing with potential conflict of interest situations;
 - (iii) commitment to serve the company, due diligence and integrity; and
 - (iv) confidence to stand up for a point of view.

For large companies, the MCGC also states that independent experts (i.e. those with no connection with the company, directors or major shareholders) need to be engaged to facilitate objective evaluations.²⁵ However, the process of evaluation is more flexible for other companies, with the MCGC providing options like self-assessment, peer review, or evaluations facilitated by the company secretary.²⁶ Further, the MCGC requires that the identity of the independent third party, where one was used for the board evaluation needs to be disclosed.²⁷ Next, the disclosure has to explain how the evaluation was conducted and the criteria used for the assessment.²⁸ Finally, the results of the evaluation i.e. the key strengths and/ or weaknesses identified and the proposed steps to address the weaknesses identified must be disclosed.²⁹

10. I submit that a similar set of factors that help focus the evaluation on the existence of diverse perspectives and the exercise of independent thought by directors, especially independent directors must be included in Recommendation 1.6.

Drafting change

Recommendation 1.6 should read as follows:

Recommendation 1.6:

A listed entity should:

(a) have and disclose a process for evaluating the performance of the board, its committees and individual directors for each reporting period; Such evaluation, particularly for independent directors, should include an assessment of their will and ability to critically challenge and ask questions; and

(b) disclose, for each reporting period, whether a performance evaluation was undertaken in accordance with that process, the outcome of such evaluation.

Recommendation 1.5

11. Recommendation 1.5 in the Consultation Draft states:

A listed entity should:

(a) have and disclose a diversity policy;

(b) through its board or a committee of the board:

(i) set measurable objectives for achieving gender diversity in the composition of its board, senior executives and workforce generally;

²⁴ MCGC 5.1 [28].

²⁵ Ibid.

²⁶ MCGC, 5.1 [28].

²⁷ MCGC, 5.1 [29].

²⁸ Ibid.

²⁹ Ibid.

(ii) charge management with designing, implementing and maintaining programs and initiatives to help achieve those measurable objectives; and
(iii) review with management at least annually the entity's progress towards achieving those measurable objectives and the adequacy of the entity's programs and initiatives in that regard; and

(c) disclose in relation to each reporting period:

(i) the measurable objectives for achieving gender diversity set by the board or a committee of the board;

(ii) the entity's progress towards achieving the measurable objectives;

(iii) whether the review referred to in (b)(iii) above has taken place; and

(iv) either:

(A) the respective proportions of men and women on the board, in senior executive positions and across the whole workforce (including how the entity has defined "senior executive" for these purposes); or

(B) if the entity is a "relevant employer" under the Workplace Gender Equality Act, the entity's most recent "Gender Equality Indicators", as defined in and published under that Act.

If the entity was in the S&P / ASX 300 index at the commencement of the reporting period, the measurable objective for achieving gender diversity in the composition of its board should be to have not less than 30% of its directors of each gender within a specified period.

12. With respect to this Recommendation 1.5, I submit that the requirement in clause b (ii) of the recommendation should be modified to clarify that programs and initiatives should not merely be oriented at outcomes (i.e. at achieving 'measurable objectives') alone, but at making the workplace more inclusive not only for women but for people of diverse backgrounds and also for disabled people. This is in line with the definition of diversity in Consultation Draft (provided in Box 1.5) which provides suggestions for the content of the diversity policy. The second point in the suggested diversity policy content is as follows:

1. Express the organization's commitment to diversity at all levels and in all its facets, including gender, marital or family status, sexual orientation, gender identity, age, physical abilities, ethnicity, religious beliefs, cultural background, perspectives and experience.

I support this definition and my proposed change to Recommendation 1.5 aims to underscore this commitment by requiring the programs and initiatives to support this broad definition of diversity rather than be restricted to gender diversity.

13. I further submit that the disclosures required under Recommendation 1.5 should include details of the review referred to in clause b (iii) of the recommendation, i.e. details about the company's programs and initiatives to help make the workplace more diverse in a broad sense (i.e. not restricted to gender diversity). This would help inform investors and other stakeholders about how serious the company is about creating an inclusive culture and thus building and retaining a diverse workforce.

14. To provide more guidance in the regard, the commentary should elaborate upon programs and initiatives that make mentorship programs available from the mid-management level, make promotion metrics gender neutral and create multiple channels for employees to make complaints regarding bullying or sexual harassment without fear of retaliation. This will naturally attract diverse candidates at various levels of the company's workforce. Although the issues of sexual harassment and bullying have been dealt with under the 'code of conduct' under Recommendation 3.2, it is crucial to link these efforts with diversity if the numerical targets proposed are to be sustainable. Thus, if companies do not achieve the target (30% in case of ASX 300 companies), investors and other stakeholders will be able to see information about the company's efforts in this regard. Such information is useful since the initiatives might not immediately result in increased numbers. Besides, excessive focus on 'measurable

objectives' for gender diversity alone will shift the focus from ensuring a diverse board (in terms of facets like experience, age and perspectives) that can counter groupthink and perform its monitoring role effectively.

Drafting change

Recommendation 1.5 should read as follows:

A listed entity should:

(a) have and disclose a diversity policy;

(b) through its board or a committee of the board:

(i) set measurable objectives for achieving gender diversity in the composition of its board, senior executives and workforce generally;

(ii) charge management with designing, implementing and maintaining programs and initiatives to help achieve those measurable objectives and to create and support a diverse and inclusive culture; and

(iii) review with management at least annually the entity's progress towards achieving those measurable objectives and the adequacy of the entity's programs and initiatives ~~in that regard~~; and

(c) disclose in relation to each reporting period:

(i) the measurable objectives for achieving gender diversity set by the board or a committee of the board;

(ii) the entity's progress towards achieving the measurable objectives and creating and implementing programs to promote a diverse and inclusive culture;

(iii) whether the review referred to in (b)(iii) above has taken place; and

...

Commentary to Recommendation 1.5 (on p.14) should read as follows:

...

If the board decides to delegate to a committee of the board (such as the nomination or remuneration committee) the task of setting the entity's gender diversity objectives, this should be reflected in the charter of the committee in question.

Programs and initiatives that give effect to diversity objectives may include mentorship programs from mid-management level, gender neutral promotion metrics and multiple channels for receiving employee complaints so as to prevent retaliation.

The diversity objectives the board or a committee of the board sets should include appropriate and meaningful benchmarks that are able to be, and are, monitored and measured. These could involve, for example:

...

Conclusion

15. I would conclude by emphasising that board diversity can significantly help make boards more effective if the right factors are emphasised. The ability of the board to act independently is supported by diversity of all forms and not just gender diversity. On the other hand, gender equality is important at all levels of the company and putting in place programs to make the company inclusive to diverse candidates at various levels will attract and retain diverse talent. Thus, the focus should be on such long-term measures rather than on short-term outcomes of achieving numerical gender targets on the board that might not necessarily help boards fulfil their monitoring role.