

Investor Guide to Understanding Board Diversity

What is Board Diversity?

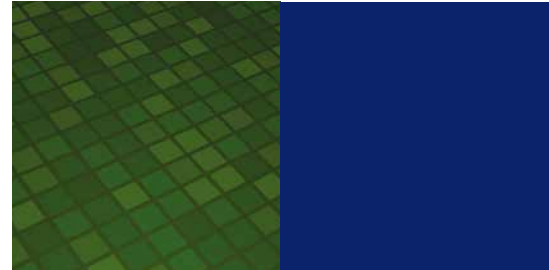
The Code of Corporate Governance states that, “The Board and its board committees should comprise directors who as a group provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company. They should also provide core competencies such as accounting or finance, business or management experience, industry knowledge, strategic planning experience and customer-based experience or knowledge.”



This Guide seeks to help Investors focus on the following:

- What is Board Diversity?
- Why is Board Diversity important?
- What are some considerations when appointing new directors?
- What are some key points in assessing board diversity?

In the next few pages, we cover these issues to help investors enhance their overall understanding of board diversity and its importance, as well as aiding them to make better decisions when considering and assessing board diversity.



Diversity in the Composition of the Board

Code of Corporate Governance

Guideline 2.6 of the Code of Corporate Governance states that, “The Board and its board committees should comprise directors who as a group provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company. They should also provide core competencies such as accounting or finance, business or management experience, industry knowledge, strategic planning experience and customer-based experience or knowledge.”

Board Composition – a Strategic Decision

In considering the composition of the board, it is important that the board as a whole is able to lead the company for continued business success. Companies do well to think strategically about the future and what skills the board would need when embarking on a recruitment exercise for new directors. Farsighted boards will be on the lookout for the acquisition of cutting-edge skills and experience that will count to the company’s competitiveness in the future. Major investments, cross-border geographical expansion and regulatory climate are examples of factors that may call for different expertise to be added to the board.

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Importance of Board Diversity for Investors

Improve Ability to Discharge Fiduciary Duties

From a corporate governance perspective, some of the most compelling arguments in support of board diversity are those linking diversity with an improved ability to discharge fiduciary duties. A diverse board is able to incorporate more varied information into its deliberations, accommodate a wider variety of perspectives for critical debate and thus enhance the potential for quality of judgement on business and risk matters.

Avoid Groupthink

A diversified board reduces the probability of “groupthink” which is associated with less critical endorsement of proposals and reluctance to break with convention. Instead, being alert to opportunities and responsive to market developments characterise more successful companies.

Access to Resources and Greater Networks

A diverse board is likely to find it easier to understand its customers and connect with internal stakeholders, remain keenly alive to future challenges and obtain heightened awareness to potential disruptive technologies. It draws on a wider reach of understanding and networks. A more homogenous group of directors may not as easily pursue new approaches and think along unconventional lines when the situation calls for significant change.

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Related Considerations in the Appointment of New Directors

Board Assessment

Effective boards review their performance regularly, usually annually. As part of the assessment, the board should examine whether it possesses the range of expertise required for the goals it would like to achieve in the coming period. Gaps can be filled with new board appointments and the composition of the board rebalanced to increase its effectiveness. This is an opportunity to increase diversity if that is assessed to be what the board needs.

Cast the Net Far and Wide

Better boards cast the net widely when recruiting directors. The natural tendency to use personal networks when looking to identify candidates may give rise to self-reinforcing homogeneity. It is advisable for the company to recruit the most qualified candidates by reaching beyond its existing personal networks to where there are new skillsets. Similarly, a company intending to expand geographically might appoint a director who possesses the cultural attributes to contribute insights about the new markets. Employing the services of executive search firms could expand the recruitment pool of candidates significantly.

Create a Quality Group of Directors Through Forward Planning

Constructing a quality board is not just about the calibre of individual directors, but also the deliberate creation of a dynamic and chemistry for the effective execution of corporate governance and strategic oversight. Creating a board composed of directors with a broad range of perspectives is a conscious choice. Identifying director retirements in good time affords the opportunity to be thoughtful about succession and diversity. The inclusion of individuals with differences in leadership styles and backgrounds, with consequential changes in board dynamic, would benefit from a longer process of due diligence and preparation.

Gender Diversity regarding Women on Boards

Gender diversity in the boardroom has been gaining attention both globally and in Singapore. Most jurisdictions are actively raising the number of women board directors. Gender is one of the diversities open to boards and should be considered for its economic value. A study by the Diversity Task Force regarding Women on Boards published in April 2014 holds that gender diversity on boards contributes to more robust decision-making, governance and shareholder value. It reflects the reality of women's increased involvement in economic decision making, and having fewer women on boards ignores a talent pool possibly at the cost of competitiveness.

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Assessing Board Diversity from Company Disclosures

An understanding of board diversity can be obtained from descriptions of governance and board matters in the annual report, announcements of board appointments and exits, as well as from specific questions posed to the board at annual general meetings.

Avoid Perfunctory Descriptions

Companies, who avoid perfunctory descriptions but explain more clearly their board nomination and selection process, and substantiate their decisions with rationale, are being transparent and cultivating shareholder understanding and appreciation of important aspects of governance.

Board Diversity Disclosure

Any policies on board appointments including policies on diversity, initiatives the company has in place and steps it is taking to promote board diversity, would be in the annual report. The actions of the Nominating Committee and its consideration of board composition would also be included, providing a picture of how the board views diversity and its actions in this regard. Guideline 4.6 of the Code of Corporate Governance requires a description of the process for the selection, appointment and re-appointment of directors to the board to be disclosed in the company's annual report, which should also include disclosure on the search and nomination process. Investors can also gain a deeper understanding of the effectiveness of the board and any role diversity has played, from the annual report, as Guideline 5.1 of the Code of Corporate Governance further requires the board to disclose how the assessment of the board, its board committees and each director has been conducted.

Individual Appointment

The Listing Manual requires a company to make immediate announcement of any appointment and resignation of directors. Required disclosures on board appointment include the board's commentary on the rationale, selection criteria as well as the search and nomination process. Thus individual announcements of appointment can provide rich ground for learning about the board's composition and diversity. For example, investors should look out for the rationale for director appointment, noting not just how the nominee qualifies for appointment but also why he stands out over other candidates and how he fits with the rest of the directors on the board. The explanation would allow understanding of whether and how diversity was achieved.

Questions at Annual General Meetings

Annual general meetings are important avenues for investors to interact with the board and management of listed companies. Investors can pose meaningful questions on board diversity and its effectiveness, as well as elicit direct justification from the board before approving new director appointments.

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