Diversity on boards and in senior management

MCCG Intended Outcome 4.0
Board decisions are made objectively in the best interests of the company taking into account diverse perspectives and insights.

MCCG Practice 4.4
Appointment of board and senior management are based on objective criteria, merit and with due regard for diversity in skills, experience, age, cultural background and gender.

MCCG Practice 4.5
The board discloses in its annual report the company’s policies on gender diversity, its targets and measures to meet those targets. For **Large Companies**, the board must have at least 30% women directors.

The internalisation and application of the content “Why” and “How” should be read in tandem with the line of sight outlined by the Intended Outcome.

**Why**

Case for change

Diversity is a critical attribute of a well-functioning leadership team. It is widely accepted that a more diverse leadership team better reflects the realities of the society, strengthens strategy formulation and risk management by adding varying perspectives and enhances the overall credibility of the company.

Boards need a diverse range of perspectives to respond to the shifting market landscape:

- changes in business model – a mix of insights is needed to understand the different drivers that are impacting the business model of the industry. These drivers may include innovation in the financial markets and the emergence of disruptive technologies.
- changes in consumer demands – strategic direction from the leadership level need to match and respond to real-time market signals from consumers.
- new and emerging risks – discussions at leadership level need to be broadened and enriched to cover nascent risk areas such as cybersecurity, reputational and social risks.

On the contrary, experiences from the past have shown that the effectiveness of board and senior management can be severely hampered by lack of diversity which creates **“groupthink”** and **“blind spots”**.

A growing body of research and empirical studies has shown that the pursuit of the diversity agenda makes business sense as companies which embrace diversity are associated with stronger financial performance. For example, a regional study conducted by Korn Ferry in 2016 across the largest 100 companies in 10 Asia Pacific countries, including Malaysia illustrated that companies with at least 10% female board representation recorded higher

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**What could go wrong:**

- Prevalent instances of board members and senior management advocating common views which dilute objective assessment and challenge process during the deliberations.
- Lack of fresh insights and new perspectives at the leadership level which hinders the company from driving innovation.
- Adoption of overzealous stance by the board which could result in an unhealthy tension between directors and also between the board and management.
returns (Return on Assets and Return on Equity) than companies which lack thereof\(^1\).

Similarly, a global study by McKinsey in 2015 covering 366 public companies across a range of industries in Canada, Latin America United Kingdom, and United States revealed that companies in the top quartile for gender or racial and ethnic diversity are more likely to reap the “diversity’s dividend”\(^2\) by having financial returns above their national industry’s medians\(^3\). The “diversity’s dividend” for gender-diverse and ethically-diverse companies is illustrated in the diagram below:

![Diversity’s dividend diagram]

**Point for reflection**

It is commonplace for companies to erroneously view “meritocracy” and “diversity” as a trade-off. Indeed, the “Analysis of Corporate Governance Disclosures in Annual Reports” performed by Bursa Malaysia in 2016 across 280 listed issuers revealed striking findings in this regard. As highlighted in the analysis, a substantial majority of listed issuers disclosed that whilst they were aware of the enumeration under the predecessor **Malaysian Code on Corporate Governance (MCCG 2012)** which calls for companies to have a policy formalising its approach to boardroom diversity, their policy was to make appointments to the board based on merit. This is compounded by the fact that only 5% of the said listed issuers disclosed the targets and measures to appoint more women on boards.

To this end, it is imperative for companies to dispel the misconception and view the elements “meritocracy” and “diversity” as complementary to each other. The pursuit of meritocratic ideals without due consideration of diversity could result in a missed opportunity for the board to consider a breadth of perspectives. Likewise, the pursuit of diversity without due consideration of merit criteria could result in “tokenism”, whereby the appointed director is unable to add tangible value to the board.

As Scott Page (an academician in Sante Fe Institute, United States) explains, the aforementioned situation is akin to comparing “apples to a fruit basket”. An apple, like a director candidate, may be evaluated as desirable based on his or her individual characteristics. In contrast, the fruit basket is evaluated on the basis of how the arrangement of fruits complement each other as a whole. It is therefore important for both the factors to be considered when selecting board members\(^4\).

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1. *Building diversity in Asia Pacific Boardrooms* 2016, Korn Ferry
2. Diversity’s dividend” refers to the benefits that can be gathered by companies that put in place constructive diversity policies and procedures.
Given the value proposition of diversity, markets globally are increasingly recognising the need for companies to incorporate diversity as a key strategic consideration. In Malaysia, such efforts are primarily carried out through disclosure-based requirements.

**Paragraph 15.08A(3)(a) of Bursa Securities Listing Requirements**

The listed issuer must provide, in its annual report, a statement about the activities of the nominating committee in the discharge of its duties for the financial year. Such statement must include how the requirements set out in paragraph 2.20A of these Requirements are met and contain the following information:

(a) the policy on board composition having regard to the mix of skills, independence and diversity (including gender diversity) required to meet the needs of the listed issuer;

*Note: Bursa Malaysia Securities Berhad has vide its directive dated 22 July 2014 clarified that a listed issuer is required to disclose in its annual reports issued on or after 2 January 2015, its diversity policy for its board of directors in terms of gender, age and ethnicity as part of the enhanced disclosure requirements to paragraph 15.08A of Bursa Securities Listing Requirements.*

It should also be noted that paragraphs 9.19(12), (14) and (14A) of Bursa Securities Listing Requirements outlines that the announcements of changes in the board of directors, chief executive and chief financial officer of a listed issuer must include the gender of the person appointed.

In addition, paragraphs 3, 4 and 4A in Part A, Appendix 9C of Bursa Securities Listing Requirements outline that the particulars of each director, chief executive and key senior management of a listed issuer in its annual report must include the gender of such director, chief executive and key senior management.

**HOW The practice in substance**

In fostering diversity, boards should formalise a policy, set targets and annually assess both the targets and the company’s progress in achieving them.

In tandem with the heightened emphasis on the dimension of gender, boards should also demonstrate clear commitment to developing a corporate culture that also embraces the aspect of gender diversity.

Key considerations relating to the application of Practices 4.4 and 4.5 are discussed on the following page.

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5 Paragraph 2.20A of Bursa Securities Listing Requirements stipulates that every listed corporation, management company or trustee-manager must ensure that each of its directors, chief executive or chief financial officer has the character, experience, integrity, competence and time to effectively discharge his role as a director, chief executive or chief financial officer, as the case may be, of the listed corporation, or the collective investment scheme.
What are the elements that can be considered in the formulation of a diversity policy?

Suggestions for the content of a diversity policy (non-exhaustive):

- Communicate the definition of diversity and recognise that diversity includes numerous dimensions including skills, experience, age, ethnicity, and gender.
- Articulate the benefits of diversity and the importance of being able to attract and retain board members and senior management personnel from a wide pool of talent.
- Express the company’s commitment to diversity at the leadership level and employee level.
- Ensure that recruitment and selection practices at all levels (from the board downwards) are appropriately structured so that a diverse range of candidates are considered and that there are no conscious or unconscious biases that might discriminate against certain candidates.
- Identify and implement programmes that will assist in the development of a more diverse pool of skilled and experienced employees that, over time, will prepare them for senior management and board positions.
- Introduce key performance indicators (“KPIs”) for senior management personnel to measure the achievement of diversity objectives and link part of their remuneration (either directly or as part of a “balanced scorecard” approach) to the achievement of those objectives. Examples of such KPIs could include number of suitable candidates sourced for leadership positions, reduction in incidences of discrimination cases reported and participation of employees in diversity programmes organised by the company.

Guidance 5.2 of the Malaysian Code on Institutional Investors (“MCII”) urges that institutional investors should assess the quality of disclosures made by investee companies on the application of the Corporate Governance Code. This, amongst others, includes disclosure of diversity targets and policies, including gender, age and ethnicity. In tandem with this clarion call by the MCII, the Retirement Fund Incorporated of Malaysia encourages its investee companies to disclose their workforce ethnicity composition in the annual report.

What are the key elements that should be included in providing disclosures on gender diversity?

Elements that should be contained in relation to disclosures on gender diversity are outlined in Practice 4.5 of MCCG as follows:

- policies on gender diversity;
- targets set on gender diversity; and
- measures undertaken to meet the aforementioned targets.

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* Guideline 3.2.1 of Corporate Governance Principles and Voting Guidelines 2014, Retirement Fund Incorporated

† Blackrock supports effort to boost number of women board members 2017, The Star
An illustrative disclosure in this regard is outlined below:

**Illustrative disclosure**

**Policy statement**

Since the launch of the Board Diversity Policy in 2012, the Board has made progress in broadening the diversity of the Board and senior management. In 2015, the Board reviewed the policy to ensure that it continues to drive the benefits of a diverse Board and workforce across the business.

The Board agreed that the ambitions and objectives set out in the policy remain relevant targets against which to measure our progress (i.e. maintain a level of at least 30% female directors on the Board over the short to medium term).

**Progress Update**

Changes to the Board were made during the year to 2 April as the Board experienced two retirements and one resignation. Despite the reduced overall size of the Board, the percentage of women on the Board remains strong at 36% at time of publication.

The Board remains committed to maintaining at least a 30% female representation on the Board, whilst ensuring that diversity in its broadest sense remains a central feature. As a result, the Nomination Committee will continue to recommend appointments to the Board based on diversity measured against meritocracy and other objective criteria such as skills and experience the individual offers.

The Board is also committed to strengthening the pipeline of senior female executives within the business and has taken steps to ensure that there are no barriers to women succeeding at the highest levels within Mark & Spencer.

**Other measures on gender diversity include:**

- assist the development of a pipeline of high-calibre candidates by encouraging a broad range of senior individuals within the business to take on additional roles to gain valuable Board experience;
- consider candidates for appointment as non-executive directors from a wider pool, including those with little or no listed company board experience;
- ensure long lists of potential non-executive directors include 50% female candidates;
- only engage executive search firms who have signed up to the voluntary Code of Conduct on gender diversity and best practice;
- report annually against these objectives and other initiatives taking place within the Company which promote gender and other forms of diversity; and
- report annually on the outcome of the Board evaluation, the composition and structure of the Board as well as any issues and challenges the Board is facing when considering the diverse make-up of the Company.

Adapted from Marks and Spencer’s annual report for the financial year end 2 April 2016

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**Target of 30% women on board.**

The Malaysian government outlined a vision for women participation on the boards of all public listed companies to reach 30% by the year 2020. Given the socioeconomic impact that large companies bring to bear, they are expected to lead the way in meeting the nation’s goal.

In advancing the gender diversity agenda, boards should take steps to ensure that women candidates are sought in its recruitment exercise. For example, when the need for a new director is identified or a casual vacancy arises, suitably qualified women candidates should be identified and considered. This should also be extended to senior management personnel as they form a talent pipeline for board candidacy.

Efforts in this regard will place the board in a good stead to benefit from greater diversity without compromising on the selection criteria of a director.
How can the board articulate the diversity of skills that the board is seeking to achieve in its composition?

It is increasingly regarded as a good governance practice for the nominating committee or board to outline a skills matrix in relation to its board composition. A company’s board skills matrix typically illustrates the mix of skills that the board currently has (current skill set) and is looking to achieve in its membership (envisioned or ideal skill set).

Facilitated by the company secretary, the nominating committee should also consider reflecting on any gaps in skills that may be created by the forthcoming retirement of a director or any change in the company’s strategic direction. This will enable the nominating committee to have a productive discussion on how the board and board committees are constituted currently and also how the nominating committee believes they should best be constituted in the future.

In this regard, the matrix will serve to guide the board in the selection of new candidates besides providing stakeholders with a collective view to evaluate the competencies of the board. It is therefore important that the desired skill sets are regularly reviewed by the nominating committee to ensure alignment with the objective, strategic direction and emerging challenges faced by the company.

A hypothetical example of a board skills matrix for a development financial institution based on the suggested skill set prescribed by the Bank Negara Malaysia’s Guidelines on Corporate Governance for Development Financial Institutions 2011 is depicted below (Note: The difference between current skill set and the ideal skill set indicates existing gaps that the board is seeking to bridge):

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Appendix II of this Pull-out outlines a sample assessment to determine the knowledge, skills and experience of the current board, in light of the company’s business and strategies.

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* Guidelines 2.17 and 2.18 of Bank Negara Malaysia’s Guidelines on Corporate Governance for Development Financial Institutions 2011
Case study: Mangalore Chemical and Fertilisers Ltd (India)

**Background:**
- Section 149(1) of the Companies Act 2013 in India and the subsequent guidelines (Clause 49 of the Listing Agreement) issued by the Securities and Exchange Board of India (“SEBI”) made it mandatory for all listed companies to have at least one woman on their boards, either as an executive or a non-executive director, before April 1, 2015.

**Facts:**
- In order to meet the aforementioned requirement, Ritu Mallya was appointed to be the sole women director (non-executive director) on the board of Mangalore Chemical and Fertilisers Ltd. Ritu Mallya is the step-mother of the controlling shareholder and the then Executive Director of the said company, i.e. Vijay Mallya.
- The appointment was met with strong objections from stakeholders who were unconvinced that the company would benefit from fresh perspectives emanating from an insider and family member of the current management. The company was heavily criticised for making a “token” appointment and hence, diluting the intention of the requirement which aims to enhance board effectiveness.

**Lessons Drawn:**
- Companies should internalise the spirit of law and endeavour to make sustained changes in order to truly benefit from diversity.
- At all times, the appointment of board members should be based on objective criteria, merit and with due regard for diversity.

**Regional/international perspectives**

Similar to Malaysia, many countries including United Kingdom and Australia have (via their respective codes of corporate governance) urged companies to put in place policies and procedures on diversity in order to facilitate greater inclusion and diversity, particularly on gender.

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9 Galani, U. 2015, Keeping it in the family. Reuters
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<tr>
<th>Country</th>
<th>Provision</th>
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<tr>
<td>United Kingdom</td>
<td>A separate section of the annual report should describe the work of the nomination committee including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company <em>(Provision B.2.4)</em>.</td>
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<td>Australia</td>
<td>A listed entity should:</td>
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<td>(a) have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity’s progress in achieving them;</td>
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<td>(b) disclose that policy or a summary of it; and</td>
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<td>(c) disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity’s diversity policy and its progress towards achieving them, and either:</td>
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<td>1) the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined “senior executive” for these purposes); or</td>
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<td>2) 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.</td>
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