



Government  
**Equalities Office**

Putting equality at the heart of government

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Sir Christopher Hogg  
Chair of the Financial Reporting Council  
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71-91 Aldwych  
London  
WC2B 4HN

11 March 2010

Dear Christopher

I am writing to set out the views of the Government Equalities Office in response to the consultation on the Combined Code. They reiterate the view we expressed last year that the FRC should take advantage of the Code's review to set out more clearly the need for a wide range of representation on Boards as a major contribution to improving Board performance and strengthening corporate governance. These views supplement and support those set out in the letter of 26 February from Lord Davies, Minister for Trade, Investment and Small Business. The Government Equalities Office is responsible for the Government's overall strategy, legislation, and priorities on equality issues. The Government has a strong interest in promoting greater diversity and inclusion on our Boards as a means of improving innovation and the performance of the UK economy. In the public sector, the GEO and the Cabinet Office are currently leading work to improve the diversity of public appointments and set challenging targets to this effect last year.

The GEO responded to the Financial Reporting Council's 2009 Review of the Combined Code in October 2009. In our submission, we set out our particular interest in the review of the section A.3 of the current Code, which addresses board balance, composition and independence. We also submitted evidence from our recently published research project, carried out by Cranfield University, on how to improve boardroom diversity.

Through GEO's work stream on increasing boardroom diversity, we have consulted with numerous stakeholders on this topic and have commissioned research on current initiatives that exist both in the UK and internationally to improve boardroom diversity. Informed by this work, we believe that the approach of the Combined Code provides a real opportunity to bring about the step change necessary to improve boardroom diversity.

In this brief submission, I want to set out why we believe it important for the UK to increase the diversity of its boardrooms, drawing on updated evidence, and information on the actions taken to improve boardroom diversity internationally. Based on this information, I would also like to build on Lord Davies' suggestions for principles to be included in the new Code.

## **Part 1: The importance of diverse and inclusive boards to public confidence**

Promoting diversity and inclusion will enable boards effectively to combat group-think, and provide a more challenging environment. We agree with the FRC's Final Report which recommends a new Code principle around the need for companies to be encouraged to look outside the 'usual suspects' for boards' positions<sup>1</sup>. This is the only way to ensure that UK companies are drawing from the widest possible pool of talent as we look towards economic recovery and future growth.

These points are supported by survey research which GEO has recently commissioned from Ipsos Mori, which found that more than half of respondents (59%) believe that having senior management teams of all one sex will be more likely to think in the same way and so make poor decisions. The survey also found that nearly two thirds of respondents (61%) believe businesses are losing out on talent by having fewer women in senior roles<sup>2</sup>.

In addition, the economic downturn has left many companies with the need to rebuild trust; we believe this could be more easily achieved if companies better reflect their customers and the public. This is strongly supported by our survey findings, which show that 80% of respondents believe that a balanced senior management team will be better at understanding their customers<sup>3</sup>.

The Government is also committed to a fair and family-friendly labour market for both women and men. This cannot be achieved if our boards are exclusively male, as currently a quarter of FTSE 100 companies are. Indeed, 71% of survey respondents believe having more women on senior management teams will lead to more family-friendly working practices<sup>4</sup>.

## **Part 2: The evidence relating to boardroom diversity and profitability**

The topic of boardroom diversity has been gaining increasing prominence across the globe, and there has been a good deal of scholarly research done to highlight the relationship between diverse boards and profitability in an effort to complement the business case for diversity and inclusion.

Much cited research by Catalyst found that Fortune 500 companies with a good gender balance on their board perform better. Companies with more women on their

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<sup>1</sup> FRC 2009 Review of the Combined Code: Final Report, December 2009, pg 17

<sup>2</sup> The survey was commissioned by the Government Equalities Office and conducted by Ipsos MORI. Ipsos MORI interviewed a representative quota sample of 1,071 adults in Great Britain aged 16+. Interviews were conducted by telephone between 20-24 February 2010. Data are weighted to match the profile of the population. The full research report will be published on the GEO website on 11 March 2010: [www.equalities.gov.uk](http://www.equalities.gov.uk)

<sup>3</sup> Ibid

<sup>4</sup> Ibid

boards were found to out-perform their rivals with a 42% higher return in sales, 66% higher return on invested capital, and 53% higher return on equity<sup>5</sup>.

This is supported by evidence from McKinsey & Co which shows that in Europe, those companies with a higher proportion of women on their management boards are those companies with the best performance in terms of return on equity and stock market growth.<sup>6</sup>

Findings from a study of FTSE 100 companies show that the companies with ethnic minority directors had significantly higher market capitalization, and were also significantly more likely to have women on their boards.<sup>7</sup>

In addition, findings from a study of UK boards reveal that women are significantly more likely to bring international diversity to their boards and to possess an MBA degree<sup>8</sup>. In an increasingly globalised world, international experience is a key to companies seeking to compete in the new economy.

Although the evidence cited above has not set out to show causality between diverse Boards and profitability, the correlation between a diverse and inclusive Board and improved market performance is compelling.

### **Part 3: International Perspectives**

The under-representation of women on boards of directors has been recognised as a problem in countries across the globe, with a variety of actions taken to improve boardroom diversity.

The 2003 Norwegian legislation requiring public companies to increase the percentage of women on their boards to 40% is most commonly cited example of Government legislation in this area, but several countries have looked to their example and are considering legislation. In 2007, Spain passed an 'Equality Law' which recommended that all listed companies on the stock exchange have 40% representation of each gender on their boards by 2015<sup>9</sup>. And the French parliament has recently introduced a bill which, if passed, would require companies listed on the French stock exchange to have 40% female directors by 2015.

Corporate Governance codes in other countries are also being utilised as a means to addressing the lack of diversity on Boards. Following the 2006 review of Spain's Unified Good Governance Code, the new Code explicitly stated that board nomination committees should ensure no implicit bias against women candidates and that the companies should make a conscious effort to include as directors women with the target profile<sup>10</sup>. The Spanish Code, like the UK's Combined Code, also operates on a 'comply or explain' basis.

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<sup>5</sup> "The Bottom Line: Corporate Performance and Women's Representation on Boards", Lois Joy, Ph.D., Director, Research, and Nancy M. Carter, Ph.D., Vice President, Research, at Catalyst Inc.; Harvey M. Wagner, Ph.D., and Sriram Narayanan, Ph.D., 2007

<sup>6</sup> "Women Matter: gender diversity, a corporate performance driver", McKinsey & Company (2007).

<sup>7</sup> Val Singh, "Ethnic Diversity on Top Corporate Boards: a resource dependency perspective", International Journal of Human Resource Management 18:12 December 2007.

<sup>8</sup> Dr Val Singh, Dr Siri Terjesen and Prof Susan Vinnicombe (2008) "Newly appointed directors in the boardroom: How do women and men differ?" European Management Journal, vol 26, 1, 48.

<sup>9</sup> "Increasing Diversity on Public and Private Sector Boards", Dr Ruth Sealy, Elena Doldor and Professor Susan Vinnicombe, International Centre for Women Leaders, Cranfield School of Management.

<sup>10</sup> Unified Corporate Governance Code 2006, pg 18: "When women directors are few or non-existent, the board should state the reason for this situation and the measures taken to correct it; in particular,

In December 2009, the Australian ASX Corporate Governance Council announced that it will require listed companies to disclose in their annual reports the number of women in their organisations, in senior management and on the board, as well as their achievements against the gender objectives set by their boards. Alongside the new recommendations, changes will be made to the guidance to encourage nomination committees to include in their charters a requirement to continuously review the proportion of women at all levels in the company, and to require that the performance review of the board include consideration of diversity criteria in addition to skills. Also, boards will be required to disclose what skills and diversity criteria they look for in any new board appointment. The ASX Code also works on a comply or explain basis, and the new Code is due to come into force in July 2010.<sup>11</sup>

Finland's new corporate governance code came into effect in January 2010, and requires all companies listed in Finland to have at least one woman on the board, or explain why they do not.<sup>12</sup>

#### **Part 4: New Provisions**

The GEO strongly agree with Lord Davies' proposals that the new Code should include a principle which requires listed companies to explain:

- what the current position is with regard to director posts occupied by women and other under-represented groups;
- how this meets the needs of the company, its governance and business; and,
- what their policies are for achieving greater diversity in the boardroom.

These principles should also be incorporated into the proposals put forward in the FRC's Final Report, which calls for board evaluation reviews to be externally facilitated every three years, and companies to report on their business model<sup>13</sup>.

In addition, the main principle of section A.4 of the current Code relates to the appointments to boards, and confirms that, "There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board"<sup>14</sup>. This principle should be strengthened, along the lines of the Spanish Code of Governance, by ensuring there is no implicit bias against under-represented candidates. The phrasing of such a provision could be modeled after the Spanish Code, for example:

"When women directors are few or non-existent, the board should state the reason for this situation and the measures taken to correct it; in particular, the Nominations Committee should take steps to ensure that: a.) The process of filling board vacancies has no implicit bias against women candidates; b.) The company makes a

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the Nominations Committee should take steps to ensure that: a.) The process of filling board vacancies has no implicit bias against women candidates; b.) The company makes a conscious effort to include women with the target profile among the candidates for board places"

[http://www.ecgi.org/codes/documents/unified\\_code\\_may2006\\_en.pdf](http://www.ecgi.org/codes/documents/unified_code_may2006_en.pdf)

<sup>11</sup> "New ASX Corporate Governance Council Recommendations on Diversity", 7 December 2009;

[http://www.asx.com.au/about/pdf/mr\\_071209\\_asx\\_cgc\\_communique.pdf](http://www.asx.com.au/about/pdf/mr_071209_asx_cgc_communique.pdf)

<sup>12</sup> Corporate Governance Review 2009,

<http://www.cgfinland.fi/images/stories/pdf/corporate%20governance%20review%20october%202009.pdf>

<sup>13</sup> FRC 2009 Review of the Combined Code: Final Report, December 2009, pg 3

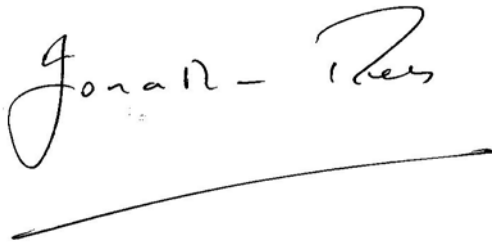
<sup>14</sup> FRC 2009 Review of the Combined Code: Final Report, December 2009, pg 9

conscious effort to include women with the target profile among the candidates for board places.”

As Lord Davies' set out, and the evidence supports, there are a number of obstacles to greater boardroom diversity. The Government will continue our drive to increase diversity on boards in the public sector, and we will work with business and recruitment firms to highlight best practice in this area. However, we strongly believe that companies need to be more transparent in how they balance their senior management teams, and that the Combined Code must be utilised in support of this aim.

Please do not hesitate to get in touch if you require any further information on the evidence or examples brought up in the submission.

Yours sincerely

A handwritten signature in black ink that reads "Jonathan Rees". The signature is written in a cursive style with a long horizontal line underneath it.

**Jonathan Rees**