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BOARD DIVERSITY REVISITED: NEW RATIONALE, SAME OLD STORY?[*]

LISA M. FAIRFAX[**]

Recently, board diversity advocates have relied on market- or economic-based rationales to convince corporate America to increase the number of women and people of color in the boardroom, in lieu of moral or social justifications. This shift away from moral or social justifications has been deliberate, and it stems from a belief that corporate America would better respond to justifications that centered on the corporate bottom line. However, recent empirical data reveals that despite the increased reliance on, and apparent acceptance of, market- or economic-based rationales for board diversity, there has been little change in actual board diversity. This Article argues that the relative stagnation in board diversity can best be attributed to diversity advocates' overemphasis on the importance of business rationales for diversity, coupled with their failure to acknowledge or otherwise bolster the importance of social and moral justifications for board diversity efforts. As a result, this Article not only concludes that business justifications may be insufficient, at least standing alone, to advance board diversity, but also insists that diversity advocates must pay greater attention to the role of social and moral justifications in the effort to diversify the corporate boardroom.

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INTRODUCTION

In recent years there has been considerable scholarly and regulatory focus on board diversity,[1] defined in this Article as the portion of women and people of color on a corporate board.[2] This focus is perhaps best exemplified by a new U.S. Securities and Exchange Commission ("SEC") rule requiring public companies to provide disclosure of the extent to which their boards consider diversity in the director nomination process.[3] This disclosure requirement appears to highlight the importance investors place on board diversity.[4]

Historically, advocates of board diversity—like advocates of diversity in other sectors—relied on moral or social justifications to convince people of the desirability of such diversity.[5] Such

1. *See, e.g.*, DOUGLAS M. BRANSON, NO SEAT AT THE TABLE: HOW CORPORATE GOVERNANCE AND LAW KEEP WOMEN OUT OF THE BOARDROOM 3–6 (2007); Lissa Lamkin Broome & Kimberly D. Krawiec, *Signaling Through Board Diversity: Is Anyone Listening?*, 77 U. CIN. L. REV. 431, 432 (2008). With regard to regulation, Norway passed a law requiring public companies to appoint women to hold some forty percent of board seats. Stephanie Holmes, *Smashing the Glass Ceiling*, BBC NEWS (Jan. 11, 2008), www.http://news.bbc.co.uk/2/hi/business/7176879.stm. Moreover, in 2009, the SEC passed a rule requiring disclosures related to board diversity. *See* SEC Corporate Governance, 17 C.F.R. § 229.407(c)(2)(vi) (2010).

2. Although there are many different forms of diversity, including race, gender, national origin, sexual orientation, and viewpoint, consistent with my earlier articles, this Article focuses on gender, racial, and ethnic diversity. This Article uses the term "people of color" to refer to African Americans, Hispanic Americans/Latinos, Asian Americans, and Native Americans as a group.

3. § 229.407(c)(2)(vi); *see also* Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,343–44 (Dec. 23, 2009) (discussing the reasons why the SEC found it important to adopt these measures).

4. Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,355.

5. *See* David B. Wilkins, *"From Separate Is Inherently Unequal" to "Diversity Is Good for Business": The Rise of Market-Based Diversity Arguments and the Fate of the Black Corporate Bar*, 117 HARV. L. REV. 1548, 1553 (2004); *see, e.g.*, J. Cunyon Gordon, *Painting by Numbers: "And, Um, Let's Have a Black Lawyer Sit at Our Table,"* 71

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justifications were premised on the notion that increasing diversity was the "right thing to do," particularly because efforts to increase diversity were aimed at rectifying existing inequalities stemming from the lingering effects of slavery, segregation, and other forms of discrimination.[6]

More recently, however, board diversity advocates have gravitated toward market- or economic-based rationales for advancing board diversity.[7] These rationales, referred to herein as the "business case," rely on the proposition that increased board diversity will improve the corporation's bottom line.[8]

This rhetorical shift toward the business case and away from moral or social rationales for diversity was deliberate, and it stemmed from a belief that corporate America would not—and in some cases could not—adequately pursue board diversity without sufficient business justifications for that pursuit.[9] The belief that efforts to advance board diversity must focus on business rationales was based on at least three presumptions. First, many diversity advocates began to believe that historical rationales based on noneconomic, social or moral grounds had proven ineffective in compelling corporate America to diversify its boardroom.[10] As a result, advocates believed they needed to develop and advance economic-based rationales that better appealed to members of the business community.[11] Second, a number of legal decisions, beginning with the Supreme Court's

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FORDHAM L. REV. 1257, 1277 (2003) (describing one university president's attitude that diversity policies are just "the right thing to do"); Vance Knapp & Bonnie Kae Grover, *The Corporate Law Firm—Can It Achieve Diversity?*, 13 NAT'L BLACK L.J. 298, 303 (1994) ("Law firms should hire more minority attorneys, of course, for reasons of simple justice."); *Taylor's Perspective . . . : Law Firms Should Lash Back at the Diversity Backlash "Movement,"* OF COUNSEL (Aspen Publishers, Inc., New York, N.Y.), June 2007, at 3, 4 ("[S]ome law firms have sought to hire minority and women attorneys for the right reason—it's the morally proper thing to do . . . .").

6. Wilkins, *supra* note 5, at 1553.

7. *See* Lisa M. Fairfax, *The Bottom Line on Board Diversity: A Cost-Benefit Analysis of the Business Rationales for Diversity on Corporate Boards*, 2005 WIS. L. REV. 795, 839–40; Wilkins, *supra* note 5, at 1548–55.

8. *See* Steven A. Ramirez, *Diversity and the Boardroom*, 6 STAN. J.L. BUS. & FIN. 85, 85–86 (2000) (noting the importance of diversity to corporate America and its boards); Wilkins, *supra* note 5, at 1553; *see also* Grutter v. Bollinger, 539 U.S. 306, 330 (2003) (relying in part on business leaders' assertions of the importance of diversity to corporate America to uphold law school affirmative action policy).

9. *See* Fairfax, *supra* note 7, at 839–40; Wilkins, *supra* note 5, at 1548–55.

10. *See* Fairfax, *supra* note 7, at 839–40; Wilkins *supra* note 5, at 1568–71 (discussing how frustration with the slow pace of change has led to an embrace of rhetoric focusing on the business case).

11. *See* Wilkins, *supra* note 5, at 1570–71.

decision in *Regents of the University of California v. Bakke*,[12] not only evidenced a growing dissatisfaction with moral and social justifications for diversity, but also signaled a burgeoning receptiveness to more market-oriented arguments for diversity.[13] Third, it is entirely possible that corporate officers and directors did not feel comfortable pursuing board diversity unless such pursuit could be justified in terms of financial or economic rationales that seemed more consistent with their fiduciary duty to maximize firm value, and presumably to enhance shareholder returns.[14] In this regard, the shift toward justifying board diversity through reliance on business rationales—and away from a focus on moral and social rationales—reflected a practical and strategic assessment that the business community would be more receptive and responsive to economically-oriented justifications for diversifying corporate boards.[15]

At first glance, it seems as if this rhetorical shift has achieved its goal. Importantly, several studies appear to establish a link between board diversity and improved financial performance, thereby providing important empirical support for board diversity's business case.[16] These studies help validate the business case and this validation appears to have increased rhetorical support for board diversity. In other words, corporations and critical members of the investment community, including the SEC, appear more willing to acknowledge the importance of board diversity, and that willingness appears to be correlated with an acknowledgement of the merits of the business case.[17] Indeed, the SEC's acknowledgement of those merits appears to have played a role in its adoption of disclosure rules in this area, suggesting that the business case has paved the way for important legislative changes.[18]

However, a closer inspection of the current empirical data reveals that, despite the increased reliance and focus on business rationales for board diversity, there has been little change in actual board diversity.[19] Instead, the percentage of women and people of

12. 438 U.S. 265 (1978).
13. *See id.* at 307–08 (plurality opinion); Wilkins, *supra* note 5, at 1554–55, 1558.
14. Fairfax, *supra* note 7, at 841.
15. *See* Wilkins, *supra* note 5, at 1568–71.
16. *See infra* Part I.A (discussing empirical evidence related to board diversity).
17. *See infra* Part I.B (discussing rhetorical support for the business case).
18. *See infra* Part I.C (discussing the adoption of the disclosure rule, and the SEC's acknowledgement of the merits of the business case).
19. *See infra* Part II (discussing empirical data on the amount of diversity in corporate boardrooms).

color on boards has been relatively stagnant, particularly over the last five years.[20]

This Article argues that this relative stagnation has implications for the merits of the business case as a tool in advancing board diversity. In fact, this Article argues that such stagnation can best be attributed to diversity advocates' overemphasis on the extent to which the business case can impact board diversity efforts, along with their simultaneous underemphasis on the important role that social and moral justifications must continue to play in such efforts. In this regard, this Article concludes that the business case, standing alone, is insufficient to ensure enhanced diversity in the boardroom.

This Article reaches this conclusion by critically examining *why* the increased embrace of the business case has not translated into increased board diversity. On the one hand, there may exist other factors that not only explain the empirical evidence related to board diversity, but also suggest that any conclusion about the merits of the business case may be premature or unreliable.[21] If these explanations have merit, then they may undermine any conclusion that reliance on the business case has proven unsuccessful. However, this Article contends that while other factors may have played a role in the relative stagnation in board diversity, they do not fully explain it. Rather, the most likely reason for the stagnation appears to be the relative ineffectiveness of the business case, at least standing alone, in motivating corporations to diversify their boards. This conclusion has important implications for board diversity efforts, suggesting that diversity advocates need to alter their strategy in this area.

Part I of this Article demonstrates the apparent success of the strategic shift toward relying on business rationales to support the board diversity effort. This Part not only reveals an increase in empirical evidence supporting the business case for diversity, but also shows a growing rhetorical acceptance and acknowledgement of the legitimacy of the business case among corporations and members of the business community. Part I concludes by outlining the new SEC rule on board diversity, which appears to have been premised on the validity of the business case for board diversity. In sharp contrast to

20. *See infra* Part II.

21. For example, one may argue that the economic crisis may have created special challenges for all diversity efforts. Then too, it is also arguable that it may be too soon to ascertain the impact of the SEC's new disclosure rule related to board diversity. To the extent that the rule stemmed from an acknowledgement of the merits of the business case, it also may be arguable that it is too soon to ascertain the impact of that case. Part III addresses these and other factors more fully.

the supposition that embracing the business case would increase board diversity, Part II highlights empirical evidence revealing that such an embrace apparently has had no impact on changing the status quo in terms of board diversity. Part III explores reasons for that lack of impact, concluding that while the business case for board diversity may prove rhetorically appealing, it is insufficient on its own to ensure a full commitment to board diversity.

I. THE BUSINESS CASE MAKES ITS CASE

The business case for board diversity encompasses a variety of different strands.[22] The unifying theme of those strands, however, is that board diversity positively impacts corporate performance and the corporation's bottom line.[23] The effort to develop and advance this theme appears to have garnered positive results in at least three respects. First, currently there is some empirical evidence demonstrating a positive link between board diversity and firm performance or positive corporate governance effects, thus seeming to support the business case for diversity.[24] Second, there seems to be an increased (albeit rhetorical) acceptance of the importance of board diversity to the corporate bottom line from both business organizations and influential business leaders.[25] Third, the SEC recently adopted a rule requiring disclosure related to board diversity.[26] Such adoption was based, at least in part, on investors' growing recognition of a connection between board diversity and corporate performance.[27] In their own way, therefore, each of these developments reflects increased acceptance of the business case for board diversity and hence positive developments for those who stress the importance of that case for board diversity efforts.

A. *The Empirical Case*

Perhaps the most devastating criticism of the business case for board diversity is that there is no empirical evidence or data to support the case. Indeed, unlike moral and social rationales, business

22. *See* David A. Carter et al., *The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance*, 18 CORP. GOVERNANCE 396, 398 (2010); Fairfax, *supra* note 7, at 810.

23. Carter et al., *supra* note 22, at 398; Fairfax, *supra* note 7, at 810.

24. *See infra* Part I.A.

25. *See infra* Part I.B.

26. SEC Corporate Governance, 17 C.F.R. § 229.407(c)(2)(vi) (2010); Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,343–44, 68,364 (Dec. 23, 2009).

27. Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,355.

rationales are susceptible to proof, and thus seem to require that diversity advocates establish the validity of the claims underlying such rationales.[28] Diversity advocates have expended considerable resources attempting to establish some empirical support for the business case.[29] Those efforts have translated into some tentative success.

Thus, there has been a growing body of studies establishing a positive relationship between board diversity and improved financial performance, measured in terms of various financial metrics including returns on equity, returns on sales, and returns on invested capital.[30] In one study, Catalyst found that companies with higher percentages of women directors financially outperformed those with lower percentages by significant margins.[31] Catalyst also found stronger-than-average performance at companies with at least three women directors.[32] Another study revealed that, over a five year period, the stocks of companies with significant board diversity outperformed both the Dow Jones Industrial Average and the NASDAQ 100,

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28. *See, e.g.*, Carter et al., *supra* note 22, at 397 (noting the importance of establishing that diversity actually enhances shareholder value).

29. *See* Press Release, Catalyst, Alliance for Board Diversity: Fact Sheet (May 11, 2005), http://www.catalyst.org/press-release/117/alliance-for-board-diversity-fact-sheet (describing how the Alliance for Board Diversity has dedicated resources to generate research that makes the business case for board diversity).

30. *See, e.g.*, Niclas L. Erhardt et al., *Board of Director Diversity and Firm Financial Performance*, 11 CORP. GOVERNANCE 102, 107 (2003) (revealing a positive relationship between gender, racial, and ethnic board diversity and both return on investment and return on assets); Kathleen A. Farrell & Phillip L. Hersch, *Additions to Corporate Boards: The Effect of Gender*, 11 J. CORP. FIN. 85, 86 (2005) (noting a positive relationship between return on assets and the likelihood of adding women directors); Lois Joy et al., *The Bottom Line: Corporate Performance and Women's Representation on Boards*, CATALYST (2007), http://www.catalyst.org/file/139/bottom%20line%202.pdf (finding a positive correlation between corporate performance and higher percentage of women board directors); VIRTCOM CONSULTING, BOARD DIVERSIFICATION STRATEGY: REALIZING COMPETITIVE ADVANTAGE AND SHAREHOLDER VALUE 4–5 (2009), http://www.calpers.ca.gov/eip-docs/about/press/news/invest-corp/diversification-strategy .pdf [hereinafter VIRTCOM WHITE PAPER]. A study of companies in Finland revealed similar results, showing that companies with significant female board members had stronger returns on assets than those with male majorities. *See* ANNU KOTIRANTA ET AL., FINNISH BUS. & POLICY FORUM EVA, FEMALE LEADERSHIP AND FIRM PROFITABILITY 4–5 (2007), *available at* http://www.eva.fi/wp-content/uploads/files/2133_Analyysi_no _003_eng_FemaleLeadership.pdf; *see also* VIRTCOM WHITE PAPER, *supra*, at 12 (discussing the correlation between female leadership and improved profitability found in the Kotiranta et al. study).

31. Joy et al., *supra* note 30.

32. *Id*. This finding not only supports the business case for board diversity, but also supports the theory that such a case can best be supported when boards achieve a critical mass of women and people of color. *See* Fairfax, *supra* note 7, at 837 (discussing the importance of critical mass for people of color on boards); Joy et al., *supra* note 30.

though they did not outperform the Standard & Poor's 500 ("S&P 500").[33] One study of U.S. firms found a positive relationship between board gender diversity and Tobin's *q*,[34] while another study of U.S. firms found a significant positive relationship between the percentages of women and ethnic minorities on the board and return on assets and equity.[35] Moreover, Virtcom Consulting ("Virtcom"), a firm commissioned by the California Public Emloyees' Retirement System ("CalPERS"), the nation's largest public pension fund and a leading corporate activist,[36] found in several instances that financial performance improved after a company implemented diversity initiatives.[37]

Of course, even this empirical evidence can be attacked as inadequate because at best it reveals correlation, not causation. In fact, researchers in this area clearly acknowledge the difficulties with establishing causation.[38] For example, it is not clear if better-performing companies (because of their increased resources, greater public scrutiny, or more prestige) attract diverse board candidates, or if diverse board candidates lead to better-performing companies.[39]

Along with these favorable studies are those that demonstrate different results. At least one study suggests a negative correlation between board diversity and firm value.[40] Some suggest that there is

33. VIRTCOM WHITE PAPER, *supra* note 30, at 10. The stocks of companies with a significant number of diverse directors gained 16.2% from July 2003 to July 2008, compared to 21.7% for the S&P 500, 15.9% for the Dow Jones Industrial Average, and 2.8% for the NASDAQ. *Id.*

34. Tobin's *q* refers to the ratio between the market value of a firm divided by the replacement cost of its assets. *See* Carter et al., *supra* note 22, at 403.

35. *See* David A. Carter et al., *Corporate Governance, Board Diversity and Firm Value*, 38 FIN. REV. 33, 51 (2003); Erhardt et al., *supra* note 30, at 107; *see also* Carter et al., *supra* note 22, at 399–400 (discussing studies).

36. *See* CALPERS CORP. GOVERNANCE, http://www.calpers-governance.org (last visited Feb. 22, 2011); Stephen Choi & Jill Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 315 (2008).

37. *See* VIRTCOM WHITE PAPER, *supra* note 30, at 15–22 (discussing a series of case studies in which Virtcom revealed that corporate focus on diversity initiatives had a significant impact on the corporation's bottom line). For example, IBM partnered its marketing group with women and ethnic minority employees to focus on potential women and ethnic minority customers, and raised sales from such employees from $10 million in 1998 to over $300 million in 2003. *Id.* at 17. Similarly, Johnson Controls formed a series of joint ventures with minority-owned businesses that led to nearly $6 billion in new profits. *Id.* at 18.

38. *See* Broome & Krawiec, *supra* note 1, at 433.

39. *See id.* at 433–34.

40. *See* Renee B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. FIN. ECON. 291, 292–93 (2009) (finding that female board members have a positive and significant impact on corporate governance,

no link between board diversity and firm value.[41] Importantly, one study attempted to test for a *causal* link between board diversity and improved financial performance by examining U.S. based firms in the Fortune 500, and did not find "any empirical evidence of causation going from board diversity to financial performance, either positive or negative."[42] The existence of these studies suggests that the business case for board diversity is both equivocal and more nuanced than once thought.[43] Such an assessment is consistent with the presumption that the business case for diversity may only find empirical support under particular circumstances,[44] such as when boards have a critical mass of diverse directors.[45]

Regardless of the mixed nature of the evidence, the empirical record is likely a net positive for diversity advocates and the business case. To be sure, there is considerably more work to be done in this area. However, even the most recent study finding no causal connection between board diversity and firm performance not only found some positive relationship between board diversity and firm performance, but also underscored the fact that the study found "no evidence of a negative link between board diversity and financial

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but they have a negative impact on firm performance measured in terms of Tobin's *q* and return on assets—though women directors may have a more positive impact on firm performance in a firm with weak shareholder rights because women tend to be better monitors).

41. *See* TROND RANDØY ET AL., A NORDIC PERSPECTIVE ON CORPORATE BOARD DIVERSITY 21–24 (2006), *available at* http://www.nordicinnovation.net/_img/a_nordic_perspective_on_board_diversity_final_web.pdf (finding that board diversity in terms of gender, age, and nationality had no significant impact on stock market performance or returns on assets within the 500 largest companies in Denmark, Norway, and Sweden); Farrell & Hersch, *supra* note 30, at 86; Caspar Rose, *Does Female Board Representation Influence Firm Performance? The Danish Evidence*, 15 CORP. GOVERNANCE 404, 404 (2007).

42. Carter et al., *supra* note 22, at 411.

43. *See* Broome & Krawiec, *supra* note 1, at 434–35.

44. *See* Carter et al., *supra* note 22, at 411 (noting that the body of research suggesting no relationship between board composition and firm performance may be attributed to the fact that "under some conditions board diversity has a positive effect on financial performance and under other conditions board diversity has a negative effect, [so that] over time and many firms, the results may cancel out leaving no measurable result").

45. The literature related to critical mass suggests that people of color may not feel comfortable expressing their views within a group if they are the only one or one of a few diverse people in the group. *See* Emily Calhoun, *An Essay on the Professional Responsibility of Affirmative Action in Higher Education*, 12 TEMP. POL. & CIV. RTS. L. REV. 1, 14–15 (2002); Fairfax, *supra* note 7, at 837; Kathryn R.L. Rand & Steven Andrew Light, *Teaching Race Without a Critical Mass: Reflections on Affirmative Action and the Diversity Rationale*, 54 J. LEGAL EDUC. 316, 317–18 (2004); *see also* Grutter v. Bollinger, 539 U.S. 306, 318–19 (2003) (emphasizing the importance of critical mass to ensuring that students of color express their views).

performance," and hence that their evidence did not refute the business case.[46] When taken together, there exists at least some—albeit tentative—empirical support that board diversity may lead to increased firm value or improved corporate governance under some conditions.

B. The Rhetorical Case

Increasingly, business leaders also appear to be embracing board diversity based on business rationales. Key leaders in the business and investment community, from Calvert Group Ltd. ("Calvert") to CalPERS, the National Association of Corporate Directors, and the Conference Board,[47] have embraced the business rationale for diversity.[48] For example, the Council of Institutional Investors (the "Council"), an association of public, union, and corporate pension funds, publishes a set of policies to serve as guidelines for what it believes to be corporate best practices; these policies include support for board diversity.[49] However, in 2009 the Council amended its board diversity statement to make clear that support for board diversity was based on the Council's belief that a diverse board "can enhance corporate financial performance."[50] The amendment was designed to reflect studies suggesting the positive connection between board diversity and firm performance.[51]

The following comments from Calvert to the SEC further illustrate the business community's embrace of the business case:

> Diversity is a critical attribute to a well functioning board and an essential measure of good governance. In an increasingly

46. Carter et al., *supra* note 22, at 411.

47. The Conference Board is a business organization supported by business executives that convenes conferences and conducts business management research, with a membership representing over 1,400 companies including nearly half of the Fortune 500. *See Our Community*, CONFERENCE BD., http://www.conference-board.org/about/index.cfm?id=1975 (last visited Feb. 22, 2011).

48. *See, e.g.*, CAROLYN BRANCATO & JEANETTE PATTERSON, BOARD DIVERSITY IN U.S. CORPORATIONS: BEST PRACTICES FOR BROADENING THE PROFILE OF CORPORATE BOARDS 6–7 (1999) (noting that diversity is a key part of good governance); VIRTCOM WHITE PAPER, *supra* note 30, at 6 (study commissioned by CalPERS).

49. *See* COUNCIL OF INSTITUTIONAL INVESTORS, CORPORATE GOVERNANCE POLICIES 4 (2010), *available at* http://www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%204-13-10.pdf.

50. Press Release, Council of Institutional Investors, Council Adopts New Policies and Endorses Principles for Reform of the U.S. System of Financial Market Regulation (May 11, 2009), http://www.cii.org/UserFiles/file/press%20release%20on%20new%20policies%2005-11-09.pdf.

51. *See id.*

> complex global marketplace, the ability to draw on a wide range of viewpoints, backgrounds, skills, experience and expertise internally increases the likelihood of making the right decisions. Director and nominee diversity that includes race, gender, culture, age, and geography helps to ensure that different perspectives are brought to bear on issues, while enhancing the likelihood that proposed solutions will be nuanced and comprehensive.[52]

In addition to these business leaders, many companies and directors express a desire for board diversity. For example, one survey demonstrated that several major companies expressed a commitment to considering diversity in the selection of board members.[53] Similarly, a recent study of S&P 500 boards found that such boards rank diversity at the top of their wish list of what they look for in board candidates, second only to financial expertise.[54] Given the sentiment expressed by many in the corporate world that diversity without a business case was an insufficient reason to act, this ranking seems to be based on a belief in the business case.[55] To be sure, not all corporations, investors, and directors express a commitment to board diversity or otherwise embrace the business case for diversity. However, the increased reliance on economic and market rationales to justify the importance of board diversity reflects the growing rhetorical acceptance of the business case within the corporate community.

C. *The SEC's Case*

In December 2009, the SEC approved a rule requiring disclosure of whether and to what extent a corporation's nominating committee considers diversity when nominating candidates to the board of

52. Letter from William M. Tartikoff, Senior Vice President & Gen. Counsel, Calvert Grp., Ltd., and Ivy Wafford Duke, Assistant Vice President & Deputy Gen. Counsel, Calvert Grp., Ltd. to Elizabeth M. Murphy, Sec'y, SEC 2 (Sept. 15, 2009), *available at* http://www.calvertgroup.com/NRC/literature/documents/sri-20100125-SEC-Proxy-Disclosure.pdf.

53. *See generally Corporate Board Diversity Disclosure Scorecard*, CALVERT INVS. (Mar. 23, 2010), http://www.calvert.com/nrc/external/sec-scorecard.pdf [hereinafter *Disclosure Scorecard*] (pinpointing several companies with disclosure on diversity prior to the SEC's new requirement).

54. *See* SPENCER STUART, 2009 SPENCER STUART BOARD INDEX 15 (2009), *available at* http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI2009.pdf.

55. *See* Carter et al., *supra* note 35, at 35.

directors.[56] Under the rule, corporations must disclose "whether, and if so how, the nominating committee . . . considers diversity in identifying nominees for director."[57] If the nominating committee or the board has "a policy with regard to the consideration of diversity in identifying director nominees," the final rules require disclosure "of how this policy is implemented" and "how the nominating committee (or the board) assesses the effectiveness of its policy."[58] This rule became effective February 28, 2010.[59]

This new rule seems to reflect an implicit endorsement of the legitimacy of the business rationale for board diversity.[60] Specifically, in explaining its reasons for adopting the new rule, the SEC referenced, among other things, the fact that commentators noted the appearance of a "meaningful relationship between diverse boards and improved corporate financial performance."[61] In this regard, the SEC's willingness to adopt the new rule can be directly linked to the apparently increased acceptance of the business case.

As this Part reveals, by emphasizing—and at least providing tentative support for—the business case for board diversity, diversity advocates have managed to encourage corporations and other relevant agencies and entities to acknowledge, and at least rhetorically support, the business case.

II. BETWEEN RHETORIC AND REALITY: DIVERSITY BY THE NUMBERS

Unfortunately, the apparent acknowledgment of the business case has not translated into changes in board diversity. Because corporations are not required to report on the diversity of their directors, the statistics in this area are difficult to obtain and often vary slightly. However, they all highlight the same troubling reality: diversity has remained relatively unchanged over the past several years.

The empirical data related to the presence of women and people of color on corporate boards reflects this lack of change. From 2005 to 2007, the percentage of Fortune 1000 corporate boards with at least

56. *See* 17 C.F.R. § 229.407(c)(2)(vi) (2010). The new rule amends Item 407(c) of Regulation S-K. Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,343 (Dec. 23, 2009).

57. § 229.407(c)(2)(vi).

58. *Id.*

59. Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,334.

60. *See id.* at 68,343.

61. *Id.*

one woman only grew by 1%, from 84% to 85%.[62] Similarly, in 2009, 89% of S&P 500 companies had at least one female director, up from 88% in 2004.[63]

A similar pattern emerges with respect to people of color. The number of Fortune 1000 companies with at least one person of color on the board grew 2%, from 76% to 78%.[64] The lack of progress has been the same for all ethnic groups, and in fact, such groups' percentage representation on the board has remained virtually unchanged since 2003.[65] Similarly, 85% of the largest 200 S&P 500 boards have at least one person of color, reflecting no change since 2005.[66] While these statistics reveal that most companies have at least one person of color or woman on their board, they also suggest that representation of such groups on the corporate board has "hit a barrier."[67]

Perhaps more troubling is the relative stagnation in the total number of board seats that women and people of color held. With respect to S&P 1500 board seats, women held 12% of such seats in 2008, "which [was] unchanged from 2005."[68] The story remains the same with respect to Fortune 500 boards. In 2003, women held 13.6%

62. KORN/FERRY INST., 34TH ANNUAL BOARD OF DIRECTORS STUDY 7 (n.d.), *available at* http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

63. SPENCER STUART, *supra* note 54, at 17.

64. KORN/FERRY INST., *supra* note 62, at 7.

65. *See id.* at 18. In 2003 and 2007, 47% of Fortune 1000 boards had at least one African American director, 19% had at least one Latino director, and the number of boards with at least one Asian board member rose from 10% to 11%. *Id.*

66. *See* SPENCER STUART, *supra* note 54, at 18. To be sure, there has been some change in the type of persons of color that hold board seats. *See id.* Hence, while the number of corporations with at least one Latino director has remained basically unchanged (from 39% in 2005 to 40% in 2009), there has been an increase in the number of corporations with at least one Asian director (from 9% in 2005 to 14% in 2009) coupled with a decrease in the percentage of corporations with at least one African American director (from 84% in 2005 to 79% in 2009). *Id.*

67. KORN/FERRY INST., *supra* note 62, at 4, 6–7.

68. RISKMETRICS GRP., BOARD PRACTICES: TRENDS IN BOARD STRUCTURE AT S&P 1,500 COMPANIES 1 (2008) (on file with the North Carolina Law Review). A board diversity study of the fifty largest corporations in North Carolina revealed that in 2010, 12.3% of the board seats were held by women, as compared to 11.2% in 2006, while 7.1% of such seats were held by people of color, up from 6% since 2006. *Corporate Board Diversity Gains in State, But Lags Fortune 100, UNC Study Reports*, UNC NEWS (May 24, 2010), http://uncnews.unc.edu/content/view/3661/70/.

of Fortune 500 board seats;[69] in 2008 that number had risen less than 2% to 15.2% of total Fortune 500 directorships.[70]

With respect to people of color, empirical evidence reveals that they hold 10% of S&P 1500 board seats—"unchanged . . . since 2004."[71] In addition, in 2007 people of color held 11% of the board seats in S&P 500, as compared to 10% of such seats in 2000.[72] Thus, there has been a mere 1% growth in seven years. For women of color, the statistical increase is even smaller as compared to women and people of color, generally. In 2003, women of color held 3% of Fortune 500 seats, and by 2008, that number had risen by 0.2% to 3.2% of directorships.[73]

Importantly, the percentage of women and people of color has remained unchanged even as corporations have added board seats. From 2004 to 2006, although Fortune 100 companies added twenty-four new board seats, women and people of color collectively had a net gain of three Fortune 100 board seats.[74] This statistic suggests that corporations have not filled new director seats with women and people of color.[75] Instead, the empirical evidence reveals that within the last several years, the overall representation of women and people of color on boards has remained relatively static.[76] This stagnation

69. CATALYST, 2003 CATALYST CENSUS OF WOMEN BOARD DIRECTORS 1 (2003), *available at* http://www.catalyst.org/file/76/2003%20catalyst%20census%20wbd.pdf.

70. *See* CATALYST, 2008 CATALYST CENSUS OF WOMEN BOARD DIRECTORS OF THE *FORTUNE* 500, at 1 (2008), *available at* http://www.catalyst.org/file/242/08_census_wbd_jan.pdf.

71. RISKMETRICS GRP., *supra* note 68, at 1.

72. Phred Dvorak, *Some Things Don't Change*, WALL ST. J., Jan. 14. 2008, at R4 (citing study by Investor Shareholder Services (now known as MSCI)). Indeed, one study reveals that the percentage of African Americans on Fortune 500 companies' boards has declined, with such directors holding 8.1% of seats in 2004 and 7.4% of directorships in 2008. *African Americans Lost Ground on Fortune 500 Boards: Blacks Remain Seriously Underrepresented*, EXEC. LEADERSHIP COUNCIL (July 17, 2009), http://www.elcinfo.com/BoardCensus.php (describing study of Fortune 500 boards); *see also* Letter from Carl Brooks, President & CEO, Exec. Leadership Council, to Elizabeth M. Murphy, Sec'y, SEC 1 (Sept. 15, 2009) (citing 2008 study of African Americans on Fortune 500 boards), *available at* http://www.sec.gov/comments/s7-13-09/s71309-142.pdf.

73. CATALYST, *supra* note 69, at 1; CATALYST, *supra* note 70, at 2.

74. THE ALLIANCE FOR BD. DIVERSITY, WOMEN AND MINORITIES ON FORTUNE 100 BOARDS 5 (2008), *available at* http://www.catalyst.org/file/86/1-17-08%20abd%20study.pdf.

75. Indeed, while boards rated finding diverse directors as one of their top priorities in seeking to fill new board positions, the number of such directors actually nominated and elected does not reflect this priority. *See* SPENCER STUART, *supra* note 54, at 15.

76. KORN/FERRY INST., *supra* note 62, at 6–7.

runs counter to the expectation and hope that board reforms would positively impact board diversity.[77]

More critically, this stagnation also runs counter to expectations regarding the manner in which an increased acceptance of the business case for board diversity would impact diversity efforts and results. Indeed, diversity advocates had hoped that relying on the business case would prompt corporations to increase their diversity efforts. Instead, these numbers reveal that such reliance may have had little impact on such efforts.

III. THE BUSINESS CASE AND ROADBLOCKS TO BOARD DIVERSITY

The relative stagnation in board diversity that the empirical data highlights is likely due to the inadequacies of the business rationale itself. In order to support this assertion, this Part considers, but ultimately rejects, other explanations for the empirical evidence set forth in Part II.

Indeed, it could be possible that factors other than the ineffectiveness of the business case better explain the empirical evidence in the previous section. This Article examines three alternative explanations for the relative stagnation in board diversity. First, one may argue that the economic crisis stymied corporate diversity efforts, not only making any current data in this area unreliable, but also making it difficult to conclusively assess the impact of the business case. Second, it may be too soon to assess how the SEC's new disclosure rule will impact diversity efforts; further, to the extent the rule was prompted by an enhanced embrace of the business case, it also may be too soon to assess the impact of the business case. Third, it is possible that the relative stagnation reflects the fact that the corporate community is still unconvinced by the empirical evidence related to board diversity. From this perspective, perhaps additional or more rigorous empirical data in this area will eventually turn the tide in favor of increased board diversity. To the extent any of these rationales are compelling, they undermine the contention that the business case has proven unsuccessful. However, an analysis of these rationales reveals that they fall short of fully explaining the empirical data. As a result, the relative stagnation in board diversity strongly suggests that the strategy of building and proving the business case has failed to sufficiently motivate corporations.

77. *See* Fairfax, *supra* note 7, at 803–11.

This Article seeks to assess the reason for that failure. Indeed, perhaps diversity advocates placed too much emphasis on trying to determine the most appropriate justifications for board diversity. Instead, other factors may have a more significant impact on determining whether corporations can and will implement policies that foster diversity. Such factors include adequate responses to the pool problem,[78] the need for a significant shift in board culture, and a better recognition and understanding of the impact of ingrained biases on diversity efforts. These other factors play a critical role in issues affecting board diversity, and coupled with the business case's rhetorical appeal, may suggest that ensuring corporate support of the business case was a necessary, but not sufficient, strategy for eventually achieving significant board diversity.

Part III first considers other explanations for the disappointing empirical data in this area and then discusses the drawbacks inherent in a diversity strategy that relies primarily, if not completely, on the business case.

A. *The Economics of Diversity*

In 2008, the worst financial and economic crisis since the Great Depression hit the United States and other global markets.[79] That crisis may have created special challenges for diversity efforts. If these challenges sufficiently account for the stalled diversity numbers, then, at the very least, the crisis may undermine our ability to assess the relative merits of the business case.

First, the mere existence of the economic and financial crisis may make it difficult for corporations to focus on anything beyond survival. As a result of the economic environment, corporations have had to make difficult choices regarding how best to allocate scarce resources in order to survive and begin the process of returning to prosperity. Board diversity may be one casualty of these choices and budgetary constraints.[80] Then, too, identifying and recruiting new,

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78. *See infra* Part III.D.2 (describing the pool problem as the notion that the pool of candidates for a diverse board may be relatively small based on the customary preference for active or retired executives and CEOs).

79. *See* Anthony Faiola, *The End of American Capitalism?*, WASH. POST, Oct. 10, 2008, at A1; Press Release, Bus. Wire, Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps Are Not Taken (Feb. 27, 2009), http://www.reuters.com/article/pressRelease/idUS193520+27-Feb-2009+BW 20090 227.

80. *See* Heather Arnet & M.J. Tocci, *Why Diversity Matters*, PITTSBURGH POST-GAZETTE, Mar. 17, 2009, at E22; William Schackelford, *Doing Diversity in Tough Economic Times*, WORKFORCE DIVERSITY NETWORK, 1, http://www.workforcediversity

diverse candidates likely requires additional outreach efforts and the expenditure of additional resources, which the current crisis may make more difficult. From this perspective, the mere existence of an economic crisis poses challenges for diversity efforts.

In addition, the financial crisis appears to have encouraged corporations to focus their board recruitment efforts on criteria that may have a negative impact on board diversity. Evidence reveals that the financial crisis has prompted corporations to actively seek out more "experienced" board members.[81] As an initial matter, this has translated into a focus on directors who previously have served on boards. Thus, in 2009, only sixteen percent of new S&P directors were first timers, by far the smallest percentage in recent years.[82] In the past five years, the total number of new appointees to S&P 500 boards dropped by twenty-five percent.[83] Given the relatively small numbers of women and people of color currently serving on boards,[84] the decrease in the number of first-time board members may well explain the relative stagnation in diverse directors.

In addition to the focus on prior board service, the economic crisis also has prompted corporations to increase their preference for directors who are retired CEOs or other corporate executives, placing directors with such experience at the top of their wish list for new directors.[85] As a result, the demand for such directors far outstrips the supply.[86] Indeed, "[a]lmost a third of new female . . . directors are current or former [executives]."[87] In light of the small percentage of women and people of color in executive suites,[88] the focus on executive level experience further undermines any attempts to diversify boards. While it is unclear what kind of impact the increased emphasis on prior service and executive experience will have on a corporation's financial performance, it is clear that it does not bode

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network.com/docs/Articles/Article_DoingDiversityToughTimes_11.08.pdf (last visited Feb. 22, 2011). *But see* Heather Joslyn, *Belts Tightened by Recession, Diversity Officers Stretch Resources*, CHRON. PHILANTHROPY, Sept. 17, 2009, at D5 (noting that while the pressure of the economic downturn has made it difficult for some organizations to focus on hiring, other organizations have continued to make strides in hiring diversity officers).

81. *See* SPENCER STUART, *supra* note 54, at 13.

82. *Id*. at 12.

83. *Id.*

84. *See supra* Part II.

85. *See* SPENCER STUART, *supra* note 54, at 12–13.

86. *See id.*

87. *Id*. at 14.

88. *See* Lisa M. Fairfax, *Some Reflections on the Diversity of Corporate Boards: Women, People of Color, and the Unique Issues Associated with Women of Color*, 79 ST. JOHN'S L. REV. 1105, 1112 (2005).

well for board diversity. In this regard, the economic crisis appears to have narrowed the criteria corporations use to identify board candidates, thereby limiting the ability of corporations to engage in significant diversity efforts.

The foregoing discussion suggests that the economic crisis may have skewed the results of diversity efforts by shrinking the pool of diverse candidates and making it more difficult to dedicate resources toward expanding that pool. It could be that once the crisis passes, corporations will be better positioned and equipped to enhance diversity in a meaningful manner. As a result, it is arguable that such a crisis hampers any attempt to draw conclusions about the effectiveness of the business case or overall diversity efforts.

However, such an argument rings hollow simply because the apparent stagnation in diversity appears to have predated the economic crisis. Indeed, diversity efforts in this area appeared to have stalled as early as 2005, at least a couple of years before 2007 and 2008, when the current crisis fully emerged.[89] From this perspective, while the economic crisis may have exacerbated diversity efforts, the crisis cannot shoulder the full blame for why diversity efforts appear to have stalled out.

B. *The Novelty of the SEC's Disclosure Rule*

One may also argue that the relative newness of the SEC's disclosure rule on diversity may make it difficult to truly assess the impact of the business case. In other words, it may be too soon to tell how the SEC's new disclosure rule will impact diversity efforts. As a result, it also may be premature to speculate as to how the business rationale has impacted board diversity.

On the one hand, the mere fact that the SEC has adopted such a rule may be viewed as a success for the business case because the rationale appeared to influence the SEC's decision in this area. Not only did many SEC comment letters focus on such a rationale, but the SEC highlighted the rationale in its adoptive release.[90] In particular, the SEC noted that the new rule could enhance board quality and decision making, two key components of the business rationale.[91]

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89. *See supra* notes 71–77 and accompanying text.

90. *See* Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,343 (Dec. 23, 2009) ("Commenters also noted that there appears to be a meaningful relationship between diverse boards and improved corporate financial performance, and that diverse boards can help companies more effectively recruit talent and retain staff.").

91. *Id*. at 68,355.

Hence, regardless of the rule's impact, the mere adoption of the rule suggests the benefits of embracing the business case.

Additionally, the rule could significantly increase the number of corporations that adopt diversity policies. To be sure, the SEC insisted that the rule was "not intended to steer behavior."[92] However, the SEC also recognized that because of the rule, boards could find it "beneficial" to disclose and follow a board diversity policy.[93] In other words, because corporations may wish to avoid admitting that they do not have a board diversity policy, the rule may encourage corporations to adopt such a policy. The SEC also recognized that the rule could encourage boards to conduct broader director searches that focus on candidates with a wider range of qualities and characteristics.[94] In these ways, the SEC acknowledged that the rule could prompt more corporations to embrace diversity procedures.

There is at least some tentative evidence indicating that the rule could have a positive impact on the corporate adoption of diversity statements. As a result of the rule, several law firms already have recommended that corporations without such policies consider adopting them.[95] This kind of recommendation suggests that the rule could spur a more widespread adoption of board diversity policies. Indeed, a limited study indicated that, as a result of the SEC rule, some corporations have altered their diversity statements to be more inclusive, while others that previously had no policy either have stated an intention to consider diversity when recruiting directors or have expressed a belief in the importance of diversity.[96]

Moreover, the rule could facilitate the adoption of more effective policies. To be sure, there is no guarantee that an increased adoption of board diversity policies will translate into an increased amount of actual board diversity. However, the SEC's rule increases the

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92. *Id.*

93. *Id.*

94. *Id.*

95. *See, e.g.*, Mark Poerio et al., *SEC Rule Changes for 2010: Be Ready to Be Held Accountable*, STAY CURRENT (PaulHastings, L.A., Cal.), Jan. 2010, at 1, 8, *available at* http://www.paulhastings.com/assets/publications/1479.pdf; *SEC Adopts Proxy Rules Changes for 2010 Proxy Season*, LEGAL NEWS ALERT (Foley & Lardner LLP, Chi., Ill.), Dec. 2009, at 1, 4, *available at* http://www.foley.com/abc.aspx?Publication=6687; Robert A. Friedel, *Amended SEC Disclosure Requirements: Practice Pointers to Facilitate Compliance in 2010*, PEPPER HAMILTON LLP (Dec. 2, 2009), http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1667.

96. *See Disclosure Scorecard*, *supra* note 53 (noting, for example that Alcoa significantly bolstered its disclosure language after the SEC adoption of the new rule in 2010 and that Citigroup included diversity language where it provided none before).

likelihood of such a translation in at least two ways. First, the rule does not merely require disclosure on the existence of a diversity policy, but also requires disclosure about how the policy is being implemented, and how a corporation assesses the policy's effectiveness.[97] Such disclosure seems to require corporations to defend their diversity policy. The need to defend the policy should incentivize corporations to adopt policies that yield results. Importantly, in its study of board diversity, Virtcom found that the existence of an outlined strategy for implementing a diversity initiative may be an important factor in promoting a company's overall profitability.[98] Hence, requiring corporations to address the effectiveness of their diversity policy could increase the potential that such a policy will lead to greater diversity. In other words, such a requirement could increase public scrutiny of existing policies, thereby encouraging corporations to ensure that those policies produce results. Second, enhanced disclosure of policies that yield results not only could give companies without policies the confidence needed to adopt their own, but also could enhance overall diversity policies by providing a public platform for corporations to trade best practices in this area.

As the foregoing discussion suggests, the SEC's adoption of a diversity disclosure rule may validate the importance of the business case for diversity. First, the very fact that the business case may have prompted the adoption of such a rule could be viewed as a critical example of the benefits of embracing the business case. Second, the rule not only may encourage more corporations to adopt diversity policies, but also may encourage corporations to ensure that those policies prove effective. Hence, it is possible that the rule could facilitate future changes in board diversity.

Moreover, because it is possible that the SEC's rule could facilitate future changes in board diversity, the current empirical data related to the progress of board diversity may be unreliable. From this perspective, it may be inappropriate to evaluate the impact of the business case until the SEC's rule has had an opportunity to take effect.

However, the nature of the SEC rule may undermine its ability to positively impact board diversity. As an initial matter, and perhaps most devastating to the rule's potential effectiveness, is the SEC's refusal to define *diversity*. Instead, the SEC left it for companies to

97. *See* 17 C.F.R. § 229.407(c)(2)(vi) (2010).
98. VIRTCOM WHITE PAPER, *supra* note 30, at 16.

define diversity "in ways that they consider appropriate."[99] While a corporation's definition may include "concepts such as race, gender and national origin," it also may include "differences of viewpoint, professional experience, education, skill and other individual qualities and attributes."[100] While these other characteristics may be relevant to good corporate governance, inclusion of them in the definition of diversity may significantly undermine the extent to which the new rule increases the number of women and people of color on the board. Instead, based on these criteria, many boards already may be able to define themselves as diverse, and thus may have no incentive to diversify their boards.[101] The failure to define *diversity* could limit significantly the ability of the SEC's new rule to alter the status quo with respect to racial and gender diversity on boards.

Another important limitation on the rule's impact may be that it does not require corporations to have an actual policy related to diversity.[102] To be sure, it may be inappropriate for the SEC to require corporations to consider diversity in their board structure. However, the lack of such a requirement undermines the rule's ability to influence adoption of diversity policies. Indeed, a Calvert study indicates that, in direct response to the SEC rule, one company (which previously had made no disclosure with respect to diversity) stated that it *does not* consider diversity in evaluating potential directors because the company does not believe that diversity "is relevant to a person's qualifications to serve on the Board," nor does the company believe that the diversity of a person's background "significantly affect[s] a person's ability to contribute to [the] Board."[103] Such disclosure not only reveals that some corporations do not consider diversity in their board recruitment, but also eloquently underscores the fact that the SEC rule may fail to encourage such consideration.

99. Proxy Disclosure Enhancements, 74 Fed. Reg. at 68,344.

100. *Id*.

101. To be sure, over the last few years, boards have increasingly focused on recruiting the same type of candidate—namely retired or active executives. SPENCER STUART, *supra* note 54, at 13. While these candidates may be diverse in their industry backgrounds, it is not clear that the candidates add to racial and gender diversity on boards. *See id.*

102. *See* 17 C.F.R. § 229.407(c)(2)(vi) (2010) ("*If* the nominating committee . . . has a policy with regard to the consideration of diversity in identifying director nominees, describe how this policy is implemented . . . .") (emphasis added).

103. *Disclosure Scorecard*, *supra* note 53 (describing disclosure from Lennar Corporation, which had previously made no disclosure with respect to its company's consideration of diversity).

It also is possible that the new rule could discourage corporate adoption of diversity policies. Corporations may shy away from adopting a policy based on the fear that the corporation would be unable to adequately defend its effectiveness. In fact, at least one commentator has recommended that boards not institute a diversity policy for precisely this reason.[104] With respect to this issue, the Calvert study demonstrates that while most corporations have responded to the new SEC rule by enhancing their disclosure on diversity and indicating their intention to consider diversity in connection with consideration of potential director candidates, several corporations made clear that they do not have a formal policy on board diversity.[105] A corporation's decision not to adopt such a formal policy may be designed to avoid the added burden of having to defend it. Hence, the rule may have the unintended consequence of limiting boards' willingness to formalize their diversity efforts.

As this discussion reveals, it is possible that the relative novelty of the SEC's new rule makes it difficult to determine the impact of the business case on board diversity, particularly because the rule creates the possibility that board diversity will improve in the future. However, the SEC's new rule has shortcomings that may hinder its overall effectiveness. These shortcomings raise considerable doubt that such a rule can enhance board diversity or otherwise serve as a successful example of the benefits associated with embracing the business case.

C. *The Fragility of the Empirical Case*

It is possible that the relative stagnation in board diversity reflects the fact that the corporate community is still unconvinced by the empirical evidence related to board diversity. As Part I reveals, the empirical evidence regarding the link between board diversity and

104. TK Kerstetter, *And Your Definition of Board Diversity Is . . .* , BOARD BLOG (Jan. 18, 2010, 7:51:50 AM), http://www.boardmember.com/The-Board-Blog-And-your-definition-of-board-diversity-is.aspx?blogid=473. Kerstetter notes, "I wonder, after reading the disclosure language, if it wouldn't be better for boards to have a formal policy on diversity going into this exercise. I say that because if you do, you will need to describe how the nominating and governance committee implements and assesses the effectiveness of that policy. It seems to me, if you aren't very effective that it would just be better to have a statement on how the nominating committee looks at diversity in board composition and save being scrutinized on its effectiveness. The point here is that you will have to define it, and if a formal policy exists, you will have to defend it." *Id.*

105. Those companies include Advanced Micro Devices Inc., AES Corp., AT&T Inc., Bucyrus International Inc., HCP Inc., Humana Inc., MEMC Electronic Materials Inc., Office Depot Inc., PPG Industries, T Rowe Price Group Inc., and TCF Financial Corp. *See Disclosure Scorecard*, *supra* note 53.

financial performance is mixed, with some studies suggesting no correlation or a negative correlation between the two.[106] Moreover, several studies demonstrating more positive results have been criticized for their empirical shortcomings.[107] Not only may the mixed empirical data suggest a need for more studies or more rigorous studies, but they also may explain why more corporations have not diversified their board—they are simply waiting for better empirical support. From this perspective, one may argue that additional or more rigorous empirical data in this area will eventually turn the tide in favor of increased board diversity.[108]

Unfortunately, the mixed state of the data may be an inevitable by-product of efforts to measure board diversity. Indeed, it is not clear whether and to what extent further empirical studies will translate into more definitive support for the business case for at least two reasons. First, as researchers indicate, it is difficult to generate empirical evidence in this area because of the difficulties with collecting data and accurately pinpointing causation.[109] In this regard, while we may have some improvement in this area, shoring up the empirical weaknesses may prove intractable. Second, the evidence in this area may be mixed precisely because the business case is nuanced and depends upon variables that may or may not exist within particular corporations.[110] Such an observation suggests that the empirical flaws may be difficult, if not impossible, to definitively resolve. Thus, as one study notes, the empirical connection between board diversity and firm performance "may be too nuanced to statistically tease out."[111] Hence, if corporations are waiting for more empirically sound results before making more significant strides with respect to board diversity, then their wait may be in vain.

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106. *See supra* notes 40–41 and accompanying text.

107. *See* Adams & Ferreira, *supra* note 40, at 292–93; *see also* Broome & Krawiec, *supra* note 1, at 433–34 (commenting generally on the difficulties of assessing the relationship between diversity and performance); Carter et al., *supra* note 22, at 400 (comparing the available empirical data and noting that statistical methods, data, and time periods investigated vary greatly so that the results are not easily comparable).

108. *See* Adams & Ferreira, *supra* note 40, at 292 (noting the difficulties with interpreting the causal connection between board diversity and firm performance); Broome & Krawiec, *supra* note 1, at 433–34 (suggesting more empirical and theoretical work is required to better understand the impact of board diversity on performance); Rose, *supra* note 41, at 412 (suggesting more research and case studies are needed to better understand the impact of women on boards).

109. *See, e.g.*, Broome & Krawiec, *supra* note 1, at 433–34.

110. *See* Fairfax, *supra* note 7, at 810–38.

111. Carter et al., *supra* note 22, at 411.

Of course, the notion that the inability of the business case to impact board diversity is solely a function of the mixed or flawed empirical data is not entirely convincing. On the one hand, to the extent that corporations believe that some empirical foundation is necessary before implementing board diversity, one would expect the existence of positive studies in this area to have had at least some impact on those corporations' diversity efforts. Indeed, there are at least some studies that have found positive links between board diversity and corporate performance.[112] One would expect that, to the extent that data was the concern, such data would prove sufficient to convince at least some corporations to enhance their diversity efforts, and hence to trigger some changes in the diversity numbers. The fact that such data exists, and that stagnation continues in the area of board diversity, suggests that the problem is broader than one related to lack of empirical proof or rigor.

Importantly, despite relatively mixed or flawed data with respect to other reforms, some corporations have been willing to embrace such reforms. For example, many experts agree that the empirical evidence related to the benefits of director independence is dubious.[113] Despite this mixed evidence, boards enthusiastically embraced such independence even before reforms mandated it.[114] This acceptance demonstrates that corporations can and will adopt board reforms despite the fragility of the evidence concerning the benefits of that reform. As a result, the corporate willingness to embrace director independence despite mixed empirical evidence undermines the presumption that the mixed empirical evidence

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112. *See supra* notes 30, 35 and accompanying text.

113. *See* Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 231 (2002); Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1500 (2007) ("Evidence that connects the increased presence of independent directors to shareholder benefit is weak at best."); Robert A. Prentice & David B. Spence, *Sarbanes-Oxley As Quack Corporate Governance: How Wise Is the Received Wisdom?*, 95 GEO. L.J. 1843, 1864 (2007) (describing the evidence as "decidedly mixed"); Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 455–58 (2008).

114. *See* Bhagat & Black, *supra* note 113, at 239 (illustrating that, prior to the enactment of federal reforms, the vast majority of public companies had boards with a supermajority of independent directors). To be sure, various federal rules currently require not only that the majority of a public board be independent, but also that certain committees be comprised completely of independent directors. *See* Fairfax, *supra* note 7, at 805–06 (describing rules). However, the movement toward a board with a majority of independent directors predated these rules. *See* Bhagat & Black, *supra* note 113, at 232–33 (noting the push for independent directors in 2000).

related to board diversity is the sole or even motivating reason for the stagnation in this area.[115]

D. Overstating the Business Case

The inability of these other rationales to fully explain the stagnation in board diversity ultimately suggests that the reasons for the stagnation rest with the business case itself. In fact, diversity advocates may have overstated the importance of the business case while failing to appreciate the continued relevance of moral and social rationales for supporting board diversity. The next section explores why shortcomings associated with the business case may be the most compelling explanation for the relative stagnation in board diversity.

1. The Business Case Unveiled

One reason why the business case has proved ineffective may be that there is no "pure" business case for board diversity. Instead, the business case is inextricably linked with the moral or social case for board diversity because moral and social rationales are embedded in the so-called business case. Thus, in describing the business case for board diversity, one researcher incorporates noneconomic rationales such as the signaling function of diversity as well as the extent to which diversity provides legitimacy with internal and external constituencies.[116] Similarly, in buttressing its business case for board diversity, Catalyst identified a number of factors that have moral or social underpinnings.[117] Specifically, Catalyst noted that board diversity signals a commitment to inclusion that is essential to hiring and retention, as well as a powerful antidote to stereotypes, and enables women to serve as role models in ways that may enhance the pipeline of available diversity candidates.[118] While each of these rationales is connected to the corporation's bottom line because it impacts the corporation's ability to hire and retain qualified employees, such rationales also implicate social and moral justifications. The fact that market-based and social/moral-based

115. Of course it should be acknowledged that issues dealing with race and gender are some of the most sensitive. Hence, it could be that corporations and boards are less willing to take action in the face of mixed data when the reform involves such issues, as compared to reforms related to other issues.

116. *See* Carter et al., *supra* note 22, at 398.

117. *See* LOIS JOY, ADVANCING WOMEN LEADERS: THE CONNECTION BETWEEN WOMEN BOARD DIRECTORS AND WOMEN CORPORATE OFFICERS 8–9 (2008), *available at* http://www.catalyst.org/file/229/wco_wbd_web.pdf.

118. *See id.*

rationales are intertwined within the business case may explain the difficulties with empirical proof in this area. More importantly, it highlights the importance of not discarding social and moral rationales, and shows that seeking to advance diversity by reference only to economic rationales may prove ineffective.

2. The Pool Problem Revisited

In the context of corporate boards, the pool problem refers to the notion that the pool of candidates that satisfy the criteria for serving on corporate boards, particularly large public corporate boards, is relatively small.[119] Board studies reveal that corporations favor directors who have executive-level experience.[120] Hence, in 2007, ninety-six percent of Fortune 1000 boards had one or more directors who was a retired executive, and such status reflected the most common characteristic of the directors.[121] Indeed, most directors are active or retired CEOs or other corporate executives who have headed a division or been a functional unit leader.[122] The number of people of color and women who fit this profile is relatively small.[123] As a result, corporations that focus on these kinds of criteria may experience a pool problem with respect to finding diverse director candidates.

To be sure, corporations may have exaggerated the extent to which the pool problem represents a significant hurdle to board

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119. *See* Fairfax, *supra* note 7, at 815; *cf.* Richard H. Chused, *The Hiring and Retention of Minorities and Women on American Law School Faculties*, 137 U. PA. L. REV. 537, 547 (1988) (discussing the pool problem in legal academia); Daniel A. Farber, *The Outmoded Debate over Affirmative Action*, 82 CALIF. L. REV. 893, 918–24 (1994) (noting the pool problem in the context of education and employment); Randall L. Kennedy, *Racial Critiques of Legal Academia*, 102 HARV. L. REV. 1745, 1813–14 (1989) (discussing the pool problem in legal academia); David B. Wilkins & G. Mitu Gulati, *Why Are There So Few Black Lawyers in Corporate Law Firms?: An Institutional Analysis*, 84 CALIF. L. REV. 493, 503–06 (1996) (addressing the pool problem in corporate law firms).

120. *See* SPENCER STUART, *supra* note 54, at 12–13.

121. *See* KORN/FERRY INST., *supra* note 62, at 18.

122. *See* SPENCER STUART, *supra* note 54, at 13.

123. Fairfax, *supra* note 7, at 816–17. The pool problem is not unique to the world of corporate directors. *See, e.g.*, Chused, *supra* note 119, at 547 (demonstrating a pool problem in legal academia); Farber, *supra* note 119, at 918–24 (asserting that the educational gap, beginning at an early age, restricts the pool of qualified minority personnel); Kennedy, *supra* note 119, at 1813–14 (stating that nonprejudicial factors play a role in the limited pool of minority legal scholars); Wilkins & Gulati, *supra* note 119, at 503–06 (addressing a theory that blacks are underrepresented in corporate law, though noting the difficulty of establishing the limits of the pool).

diversity.[124] This is because there are relatively few legal requirements for board service, and none of those requirements demands that board members have specific forms of experience or backgrounds.[125] Moreover, while it is undeniable that board service requires some understanding of financial matters and corporate affairs, there are no studies indicating that enhanced board or corporate performance is linked to ensuring that a majority or a supermajority of board members have executive-level expertise. Instead, boards or committees comprised of directors with previous managerial experience may have biases in favor of management that could undermine their ability to be independent and objective.[126] In this regard, the focus on overpopulating the board with prior executives may have negative consequences. More importantly, the fact that corporations gravitate toward board members with particular backgrounds and experience is a function of custom rather than any legal rules.[127] From this perspective, because the pool problem stems from custom rather than legal regimes, one may question the legitimacy of the problem.

Nevertheless, the pool problem remains a significant obstacle. Indeed, as a practical matter, boards continue to prefer particular types of experiences that too often are not typical of people of color.[128]

Importantly, however, diversity advocates likely hoped that the business case would motivate corporations to take steps aimed at

124. Fairfax, *supra* note 7, at 817; *cf.* Wilkins & Gulati, *supra* note 119, at 503–06 (describing the problem of actually defining the relevant pool for corporate law firms in hiring associates).

125. *See, e.g.*, MODEL BUS. CORP. ACT § 8.02 (2002) (allowing corporations to designate board requirements in the articles of incorporation or bylaws). In recent years, various SEC and federal listing rules have limited the discretion of public corporations in this area by imposing requirements related to financial expertise and independence. *See* Fairfax, *supra* note 7, at 805–08, 816 (describing independence requirements). However, none of these rules demand that directors have previous executive-level experience in order to serve on a board.

126. LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE 33–34 (2004) (noting that directors who are executives or former executives may have biases in favor of management).

127. *See* SPENCER STUART, *supra* note 54, at 12–13 (explaining that corporations show preference for directors with executive experience).

128. *See* Fairfax, *supra* note 7, at 807–10. It is also important to note that even if boards were willing to seek diverse candidates outside of this narrow pool, it is not clear that such actions would prove beneficial to those candidates. Instead, it could be that those candidates would feel excluded or be given less credence if their backgrounds or experience levels were perceived as less favorable than those of their white counterparts. Thus, whether the pool problem results from legal or extra-legal forces, it continues to serve as a practical road block to board diversity.

addressing the pool problem. Indeed, the pool problem is longstanding. Diversity advocates likely believed that convincing corporations of board diversity's importance to their financial bottom line would convince them to engage in more aggressive recruiting efforts that extended beyond their traditional pool of candidates and to take steps to expand the pipeline of available diverse candidates. To be sure, some corporations and organizations have taken steps to enhance the pipeline in this area,[129] and the results of those steps might not materialize for some time. However, it is not clear whether and to what extent corporations have actively sought to extend their search for diverse candidates. Instead, director recommendations appear to continue to come from "the usual sources," and hence, corporations have not been expansive in their search for diverse candidates.[130]

The fact that greater embrace of the business case may not have translated into more aggressive efforts to ameliorate the pool problem suggests that the business case has not had its desired effect. Moreover, it raises concerns about whether appeals to economic impulses can prompt directors to engage in broader efforts in this area. Indeed, in many ways, overcoming the pool problem requires a leap of faith because it requires corporations to expend resources in developing a stronger pipeline without proof that this development will have immediate results. It is likely that moral or social appeals may prove more effective than those that speak solely in terms of economics because they do not require concrete data; instead, they focus on "doing the right thing."[131] Then too, overcoming the pool problem may require directors to make personal commitments that may move them beyond their comfort zones.[132] Characterizing diversity in market terms may have suggested that such directors need

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129. For example, DirectWomen markets itself as "the only program specifically designed to identify, develop, and support a select group of accomplished women attorneys to provide qualified directors needed by the boards of U.S. companies, while promoting the independence and diversity required for good corporate governance." *About DirectWomen: Overview*, DIRECTWOMEN, http://directwomen.org/about (last visited Feb. 22, 2011). Corporate sponsors of DirectWomen include Kraft Foods and Walmart. *DirectWomen Board Institute: 2009 Sponsors*, DIRECTWOMEN, http://directwomen.org/sponsorship/2009-sponsors/ (last visited Feb. 22, 2011).

130. *See, e.g.*, SPENCER STUART, *supra* note 54, at 16.

131. *See* Gordon, *supra* note 5, at 1277; Knapp & Grover, *supra* note 5, at 303; *Taylor's Perspective*, *supra* note 5, at 4.

132. *See* Stacy Blake-Bear et al., *Unfinished Business: The Impact of Race on Understanding Mentoring Relationships* 12 (Harvard Bus. Sch. Organizational Behavior Faculty Unit, Working Paper No. 06-060, 2006), *available at* http://www.hbs.edu/research/pdf/06-060.pdf.

not move beyond—and may have encouraged directors to remain in—their comfort zones. By contrast, a moral or social appeal may have better luck in ensuring that directors make a personal commitment in this area. Thus, relying on market or economic terms may have served to depersonalize the board diversity issue in ways that proved unproductive.

3. Ingrained Biases

There has been a recent surge of interest in literature indicating that even people who perceive themselves as tolerant have "unconscious" or "ingrained" biases that influence their behavior when they interact with people of different races or genders.[133] Importantly, the literature suggests that unconscious biases cause people to misunderstand how they would behave in the context of issues dealing with race or gender.[134]

To be sure, some question the link between ingrained bias and discriminatory behavior. For example, some insist that studies regarding ingrained bias simply reflect the influence of prejudice, and reach the overbroad conclusion that "we are all racists at heart."[135] Others note that "researchers should exercise caution before suggesting that a given individual or group of individuals holds unconscious racist attitudes."[136] However, research does indicate that people can engage in unconscious, racially biased behavior.[137]

In the corporate setting, these ingrained biases, as opposed to overt discrimination and racism, may serve as one of the most

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133. *See, e.g.*, Mahzarin R. Banaji, *Implicit Attitudes Can Be Measured*, *in* THE NATURE OF REMEMBERING 117, 136–37 (Henry L. Roediger, III et al. eds., 2001); John Dovido & Samuel Gaertner, *Aversive Racism*, 36 ADVANCES EXPERIMENTAL SOC. PSYCHOL. 1, 1 (2004); Kerry Kawakami et al., *Mispredicting Affective and Behavioral Responses to Racism*, 323 SCIENCE 276, 276 (2009); Howard Ross, *Proven Strategies for Addressing Unconscious Bias in the Workplace*, CDO INSIGHTS, Aug. 2008, at 1, 2, *available at* http://www.cookross.com/docs/UnconsciousBias.pdf; Eben Harrell, *Study: Racist Attitudes Are Still Ingrained*, TIME (Jan. 8, 2009), http://www.time.com/time/health/article/0,8599,1870408,00.html. In a study that tracked 4,100 MBA students who graduated between 1996 and 2007, researchers found that women continue to lag behind men at every career stage. *See* Nancy M. Carter & Christine Silva, *Women in Management: Delusions of Progress*, HARV. BUS. REV., Mar. 2010, at 19, 19–20. Researchers attributed at least part of that lag to the fact that "businesses may be inadvertently overlooking bias that creeps in at initial job placement." *Id.* at 21.

134. *See* Kawakami et al., *supra* note 133, at 276–78; Harrell, *supra* note 133.

135. Amy Wax & Philip Tetlock, *We're All Racists at Heart*, WALL ST. J., Dec. 1, 2005, at A16.

136. Hart Blanton & James Jaccard, *Unconscious Racism: A Concept in Pursuit of a Measure*, 34 ANN. REV. SOC. 277, 284 (2008).

137. *Id*. at 293.

challenging impediments for women and people of color.[138] From this perspective, such biases also may influence the board selection and retention process. Moreover, such biases may be a more important factor in determining whether board diversity increases.

On the one hand, it seems more likely that moral or social appeals will prove more effective in combating ingrained biases than economic ones. On the other hand, it could be that painting these rationales in market terms has enabled corporations to ignore confronting the more difficult issues associated with ingrained biases. Ultimately, the fact that moral or social appeals may better respond to these hurdles associated with board diversity reflects the notion that the business case is insufficient on its own to fully advance board diversity. Underscoring this point, after analyzing the available and conflicting data related to the business case for board diversity, one recent study concludes that the case for board diversity should not rest solely on the impact of such diversity on a firm's financial performance.[139]

CONCLUSION

In recent years, diversity advocates have relied on business rationales to support their efforts to increase board diversity. This reliance stemmed from perceived defects in the effectiveness of social and moral rationales historically used to justify diversity efforts.[140] It also stemmed from the supposition that the business case would better motivate corporate behavior than moral or social appeals.

However, the empirical evidence suggests that the increased reliance on the business case has not translated into any appreciable gains in board diversity. Instead, there has been a relative stagnation in board diversity efforts even as more corporations and regulators appear willing to rhetorically embrace the business case.

This stagnation, therefore, calls into question the strategy of supplanting moral and social rationales in favor of the business case. Moreover, the stagnation suggests that while the business rationale may have a role to play in advancing diversity efforts, the moral and social rationales also may be critical to that advancement. Thus, diversity advocates should not allow the business case to crowd out or otherwise completely displace moral appeals. The increased attention to the business case may have prevented diversity advocates from

138. *See* Ross, *supra* note 133, at 2, 6–8.
139. *See* Carter et al., *supra* note 22, at 412.
140. *See* Wilkins, *supra* note 5, at 1554–55.

focusing on ways to articulate and perhaps legitimize noneconomic rationales for board diversity. The stagnation suggests that such a focus is necessary to the board diversity effort. Indeed, the stagnation suggests that diversity advocates must create a strategy that effectively incorporates and validates moral and social justifications.