INCREASING BOARD DIVERSITY: A NEW PERSPECTIVE BASED IN SHAREHOLDER PRIMACY AND STAKEHOLDER APPROACH MODELS OF CORPORATE GOVERNANCE

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As the world reckons with the #MeToo movement and Black Lives Matter movement, within the corporate world people are starting to take stock of board diversity. Pressure is starting to build from shareholders and stakeholders for their companies to hire diverse directors. Although diversifying boardrooms has garnered support as of late, many other members of the corporate world believe a company should not diversify simply due to external pressures and it being "the right thing to do." This Note seeks to provide a new perspective for why hiring diverse directors is essential—one that is likely digestible to the more traditional, long-established members of the corporate world and our law-making bodies: Increasing board diversity furthers a corporation's purpose. Placing the arguments for board diversity within the context of both the shareholder primacy and stakeholder approach models of corporate governance, this Note demonstrates that irrespective of which side of the corporate purpose debate one believes, diverse boardrooms are beneficial for a corporation and in fact necessary for its survival. It also advocates for short-term and long-term policies that can increase board diversity and encourage the benefits of diverse directorship to be fully realized.

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Introduction

The last decade has seen a revival of longstanding debates on corporate governance amidst the backdrop of our rapidly changing world. Globalization, capitalism, populism, and climate change—among other phenomena—have reignited discussions about the purpose of a corporation, the role of its board, the trustees of a board's fiduciary duty, the interests of company shareholders versus broader community stakeholders, and the consideration of environmental, social, and governance factors in decisionmaking.[1] At the same time, the #MeToo movement and Black Lives Matter movement have prompted important conversations about diversity, equity, and representation. As a result, many organizations have committed to internal change. In particular, dialogue on the composition of boards, specifically increasing the presence of women and people of color, has started to garner much-needed attention.

2020 alone provided notable examples of people and companies taking active steps towards increasing the diversity of boardrooms.

[1] *See* Lynn S. Paine & Suraj Srinivasan, *A Guide to the Big Ideas and Debates in Corporate Governance*, Harv. Bus. Rev. (Oct. 14, 2019), https://hbr.org/2019/10/a-guide-to-the-big-ideas-and-debates-in-corporate-governance (summarizing the corporate governance debates and outlining the changes advocated for).

Reddit co-founder Alexis Ohanian stepped down from Reddit's Board of Directors and asked the company to select a Black candidate as his replacement.[2] Prominent companies have signed on to The Board Challenge, a campaign started in September 2020 that calls upon U.S. companies to place at least one Black director in their boardrooms within twelve months.[3] Cornerstone financial institutions are taking groundbreaking action: BlackRock has indicated that it will vote against boards that are not diverse or representative of a local market's expectations,[4] State Street Global Advisors has asked its portfolio companies to provide diversity data and indicate if diversity on the board is representative of the company's stakeholders,[5] Nasdaq received approval from the U.S. Securities and Exchange Commission to require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors—one identifying as female and one identifying as an underrepresented minority or LGBTQ+,[6] and Goldman Sachs now requires at least two diverse board members to take a company public.[7]

Many arguments can justify why board diversity is vital, the most straightforward being that board diversity "is the right thing to do."[8] Yet relying solely on this motivation worries members of corporate America. Some fear that corporate diversity initiatives enacted solely to respond to and appease outside pressures imposed by today's polit-

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[2] Alexis Ohanian (@alexisohanian), TWITTER (June 5, 2020, 12:29 PM), https://twitter.com/alexisohanian/status/1268943036228292608. Just days after Ohanian's announcement, on June 10, 2020, Michael Seibel was appointed to Reddit's Board. *Reddit Welcomes Michael Seibel to Board of Directors*, REDDIT BLOG (June 10, 2020), https://redditblog.com/2020/06/10/reddit-welcomes-michael-seibel-to-board-of-directors.

[3] BD. CHALLENGE, https://theboardchallenge.org (last visited Aug. 7, 2021) (listing partners of The Board Challenge including Best Buy, ConEdison, Nasdaq, NYSE, Lyft, Salesforce, Southwest, Uber, United, Verizon, and Zillow).

[4] BLACKROCK, OUR 2021 STEWARDSHIP EXPECTATIONS: GLOBAL PRINCIPLES AND MARKET-LEVEL VOTING GUIDELINES 12 (2020), https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf.

[5] *See* Letter from Rick Lacaille, Chief Inv. Officer, State St. Glob. Advisors, to Bd. Chair (Aug. 27, 2020), https://www.ssga.com/us/en/individual/etfs/insights/diversity-strategy-goals-disclosure-our-expectations-for-public-companies.

[6] *Nasdaq to Advance Diversity Through New Proposed Listing Requirements*, NASDAQ (Dec. 1, 2020, 7:15 AM), https://www.nasdaq.com/press-release/nasdaq-to-advance-diversity-through-new-proposed-listing-requirements-2020-12-01; Order Approving NASDAQ Proposed Rule Changes Relating to Board Diversity, Exchange Act Release No. 34-92,590, 86 Fed. Reg. 44,424 (Aug. 6, 2021) (approving Nasdaq's "Board Diversity Proposal").

[7] *See* David Solomon, *Goldman Sachs's Commitment to Board Diversity*, GOLDMAN SACHS (Feb. 4, 2020), https://www.goldmansachs.com/what-we-do/investing-and-lending/launch-with-gs/pages/commitment-to-diversity.html.

[8] David A. Carter, Betty J. Simkins & W. Gary Simpson, *Corporate Governance, Board Diversity, and Firm Value*, 38 FIN. REV. 33, 34 (2003) (quoting Karen J. Curtin, executive vice president of Bank of America).

ical climate do not serve tangible value to companies,[9] while others believe such moves will increase the tokenization of minorities in corporate America.[10] This Note seeks to move beyond the moral case for diversity and argues that board diversity is necessary, not simply as a means to signal a firm's virtue but rather as an important enhancement to a firm's value. While prior scholarship has focused largely on the benefits of board diversity and its implication on a board's fiduciary duty, this Note takes a novel approach by analyzing the value of diverse boardrooms through a shareholder model *and* a stakeholder model. This Note is the first to place the conversation of board diversity in the context of today's broader corporate governance debate about a corporation's purpose, looking at their intersectionality through the light of *both* shareholder interests and stakeholder interests. In doing so, this Note incorporates an amalgamation of prior data-driven research to demonstrate that regardless of whether a corporation's purpose is to further shareholder interests or further stakeholder interests, board diversity will always be a vital benefit to the corporation.[11]

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[9] *See, e.g.*, *infra* note 250 and accompanying text; Patrick Durkin, *Investor Backlash Against 'Politically Correct' Boards*, FIN. REV. (June 18, 2018, 3:30 PM), https://www.afr.com/work-and-careers/management/investor-backlash-against-politically-correct-boards-20180615-h11fa4 (discussing the worry some investors have about trying too hard on corporate board diversity due to political correctness).

[10] *See, e.g.*, Chip Cutter, *Companies Face New Pressures to Diversify Boards. It's Sensitive.*, WALL ST. J. (Dec. 7, 2020, 5:26 PM), https://www.wsj.com/articles/companies-face-new-pressures-to-diversify-boards-its-sensitive-11607380004 (statement of Jim Taylor, BoardSource Vice President of Leadership Initiatives) ("We really would like to make sure that boards do not approach this process with a check-the-box mentality.").

[11] Although board diversity can be defined in a multitude of ways, for the purposes of this Note, board diversity refers to the placement of cisgender females and underrepresented racial or ethnic minorities as directors on a board. While typical notions of diversity include folks who identify as LGBTQ+, this Note does not include LGBTQ+ directors in its definition of board diversity. Unfortunately, there remains limited data on the representation of LGBTQ+ directors in corporate boardrooms, both due to simply a lack of representation and LGBTQ+ identity not being as easily discernable as gender and racial identity. Additionally, since many of the arguments used in this Note are based on studies on gender diversity and extrapolated to racial diversity, *see infra* Section II.A, the fact that LGBTQ+ identity is not always visible may lead to the theoretical assumptions in Section II.A not fully holding true for LGBTQ+ directors. In the future, it would be interesting to consider other underrepresented identities, especially LGBTQ+ identities, when thinking about how diversity impacts corporations. This will hopefully be possible through the work of organizations like Out Leadership. Out Leadership has dedicated resources towards improving LGBTQ+ representation on boards through conducting surveys to identify openly LGBT+ directors in *Fortune* 500 boardrooms, *see Do LGBT+ Directors Count in Fortune 500 Companies*, OUT LEADERSHIP (Oct. 19, 2017), https://outleadership.com/insights/do-lgbt-directors-count-in-fortune-500-companies, and creating Quorum, an "initiative dedicated to increasing the representation of openly LGBT directors on corporate boards," *Quorum, Dedicated to Increasing Representation of Openly LGBT Directors on Corporate Boards, Launches in San Francisco*, OUT LEADERSHIP (Oct.

This examination of board diversity through a shareholder lens and stakeholder lens proceeds in three Parts. Part I takes a historical look at diversity on boards and points to economic and societal forces that slowly increased board diversity. It also provides a detailed overview of gender diversity and racial diversity on boards as it stands today. Part II highlights the advantages of having a diverse boardroom by synthesizing past studies that have evaluated practical implications of board diversity, specifically focusing on financial, business, and social impacts. Finally, Part III delves into a renewed demand for board diversity within the context of the shareholder primacy and the stakeholder models of corporate governance. This Part's functional argument demonstrates that board diversity is valuable to a corporation, irrespective of how its purpose is defined. Lastly, this Part provides recommendations for improving board diversity, both in the short-term and in the long-term. Ultimately, these recommendations seek to ensure that board diversity is not implemented simply to demonstrate diversity and appease diversity advocates, but is implemented with intentionality and in a manner that can truly further a corporation's purpose.

I
An Account of Diversity in Corporate Governance

In the United States, corporate law requires a corporation to have a board of directors.[12] Each director works alongside the other directors to manage or direct the business affairs of the corporation.[13] U.S. law embraces a board-centric model of corporate governance since a board fulfills the need for central management, is a better decisionmaker than an individual, represents and mediates between shareholders and the broader community, and monitors management.[14] Given the significant amount of power that a corporate board wields, this Note argues that it is desirable to have boards that reflect the composition of a corporation's shareholders and community stakeholders.

21, 2015), https://outleadership.com/insights/quorum-dedicated-to-increasing-representation-of-openly-lgbt-directors-on-corporate-boards-launches-in-san-francisco.

[12] Del. Code Ann. tit. 8, § 141(a) (West 2020); Model Bus. Corp. Act § 8.01 (2020).

[13] *See* sources cited *supra* note 12.

[14] Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 Hofstra L. Rev. 89, 95–102 (2004).

A. Brief History

This short Section matches an equally brief history of diversity on boards. While a lack of records contributes to some of the brevity, it is in large part due to a historical lack of diversity. An extensive study of *Fortune* 250 companies identifies the first known female director as Clara Abbott—board member of Abbott Laboratories from 1900 to 1908 and 1911 to 1924, and wife of the Abbott Laboratories founder.[15] Coca-Cola also appointed one of the first female directors in 1934, Lettie Pate Whitehead, wife of an original Coca-Cola bottler.[16] But, on average, *Fortune* 250 companies did not start appointing a female director until 1985.[17] Of these first female directors, 41% had prior business or executive experience, 14% had academic or research experience, and 9% were themselves founders or members of the founding family, like Abbott and Whitehead.[18]

The history of board representation in underrepresented racial and ethnic minority groups is far less studied. From limited records and research, it appears the earliest Black directors were appointed to major U.S. corporations in the late 1960s and 1970s.[19] Clifton R. Wharton, Jr. was appointed to the board of Equitable Life Assurance Society in 1969; with this position, he became "the first [B]lack person to sit on the board of one of the ten largest U.S. corporations."[20] In 1971, Dr. Leon Howard Sullivan was appointed to the board of General Motors Corporation, the largest U.S. industrial corporation at that time, at the behest of its shareholders.[21] Dolores D. Wharton, Wharton, Jr.'s wife, was a corporate trailblazer in her own right, becoming the first woman and first Black director of Michigan Bell Telephone Company in 1974, Kellogg Company and Philips Petroleum Company in 1976, and Gannett Company in 1979.[22] Other prominent first Black directors include the famed-lawyer Vernon

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[15] David F. Larcker & Brian Tayan, *Pioneering Women on Boards: Pathways of the First Female Directors*, STAN. CLOSER LOOK SERIES, Sept. 3, 2013, at 2.

[16] *Lettie Pate Whitehead*, LETTIE PATE WHITEHEAD FOUND., https://lpwhitehead.org/about/lettie-pate-whitehead (last visited Sept. 1, 2021).

[17] Larcker & Tayan, *supra* note 15.

[18] *Id.*

[19] An enormous debt of gratitude to Mr. Hugh Bernard Price, senior fellow at the Brookings Institution and former president of the National Urban League, for providing a great deal of help with research in this area and pointing to several of these first directors.

[20] Susan Griffith, *Clifton Reginald Wharton, Jr. (1926-)*, BLACKPAST (Mar. 12, 2012), https://www.blackpast.org/african-american-history/wharton-jr-clifton-r-1926.

[21] Agis Salpukas, *G.M. Elects First Negro As Member of Its Board*, N.Y. TIMES, Jan. 5, 1971, at 49.

[22] *Dolores D. Wharton*, HISTORYMAKERS, https://www.thehistorymakers.org/biography/dolores-d-wharton (last visited Sept. 1, 2021); *see* Caroline V. Clarke, *This Black Woman Was a Corporate Board Activist—40 Years Ago!*, BLACK ENTER. (Dec. 18, 2019),

Jordan,[23] Ann Dibble Jordan,[24] Franklin A. Thomas,[25] and Earl G. Graves, Sr.[26]

B. Push for Diversity

Throughout the brief history of diverse boardrooms, pushes have been sparked by a combination of world events, the changing nature of our corporate world, and shareholder and consumer wants. For example, the push for Dr. Sullivan's appointment stemmed from consumer activist Ralph Nader's "Campaign to Make General Motors Responsible," which included adding diverse directors who could reflect societal views on safety and environmental concerns.[27] The first wave of women directors in the 1970s was correlated with companies' involvement in the production of consumer goods,[28] "both in smaller firms and companies producing toiletries, soaps, and drugs" and in *Fortune* 500 companies.[29] Following the Enron and WorldCom scandals and subsequent passage of the Sarbanes-Oxley Act in 2002,[30] the newly implemented guidelines created an environment that

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https://www.blackenterprise.com/this-black-woman-was-a-corporate-board-activist-40-years-ago.

[23] *See* Brett D. Fromson, *Jordan's 10 Board Positions Worth $1.1 Million*, WASH. POST, Feb. 6, 1998, at G01 (noting Vernon Jordan's extensive list of directorships on ten companies).

[24] *See Ann Dibble Jordan*, HISTORYMAKERS, https://www.thehistorymakers.org/biography/ann-dibble-jordan-2 (last visited Aug. 7, 2021) (noting Ann Dibble Jordan's appointment to the boards of Johnson & Johnson and Citigroup in the 1980s and National Health Laboratories, Brookings Institution, and Automatic Data Processing in the 1990s).

[25] *See Franklin A. Thomas*, HISTORYMAKERS, https://www.thehistorymakers.org/biography/franklin-thomas (last visited Aug. 7, 2021) (noting Franklin A. Thomas's appointment to the boards of Aluminum Company of America, Avaya, CBS, Cummins, Citicorp/Citibank, and Lucent Technologies).

[26] *See* Derek T. Dingle, *Earl Graves Sr., Founder of Black Enterprise, Passes Away at 85*, BLACK ENTER. (Apr. 7, 2020), https://www.blackenterprise.com/earl-graves-sr-founder-of-black-enterprise-and-ultimate-champion-of-black-business-passes-away-at-85 (noting Earl Graves Sr.'s position as "[o]ne of the few African Americans to serve on the boards of major corporations").

[27] *See* Richard Halloran, *Nader to Press for G.M. Reform*, N.Y. TIMES, Feb. 8, 1970, at 44 (providing a brief overview of Nader's campaign); Donald E. Schwartz, *Proxy Power and Social Goals—How Campaign GM Succeeded*, 45 ST. JOHN'S L. REV. 764, 764–66 (1971) (recapping the proposals of Nader's "Campaign GM," the subsequent shareholder vote, and General Motors' responses to the campaign).

[28] HEIDRICK & STRUGGLES INC., THE CHANGING BOARD PROFILE OF THE BOARD OF DIRECTORS 7 (1977).

[29] Kathryn Rudie Harrigan, *Numbers and Positions of Women Elected to Corporate Boards*, 24 ACAD. MGMT. J. 619, 622 (1981).

[30] Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15, 18, 28, and 29 U.S.C.). The Sarbanes-Oxley Act focused on regulating public U.S. company boards, accounting firms, and management to protect investors, create greater transparency, and ensure compliance with securities laws. Key features of the extensive Act included creating the Public Company Accounting Oversight Board, defining the

encouraged an increase in the number of women on boards.[31] And after the 2008 financial crisis, which many attributed to "aggressive, risk-taking behaviors," there was "a call . . . for leaders who are understanding, cooperative, and focused on long-term sustainability."[32] This move was categorized as a step "away from the masculine norms of the 'old boys' club' "[33] in favor of more diverse, representative leadership styles.

Today we find ourselves in another monumental push for diversity. Corporations grappling with the #MeToo and Black Lives Matter movements are addressing diversity and inclusion demands. This push is necessary, as evidence indicates diversity in boardrooms is increasing at a slow, incremental pace.[34] At the current rate of growth, it will take another eighteen years for boards to reach gender parity in the United States.[35] Additionally, there is a much greater focus on gender diversity than other types of diversity in a boardroom.[36] In a

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corporate responsibility of senior executives, increasing financial disclosure requirements, enhancing criminal penalties for white-collar crimes, and protecting whistleblowers.

31 *See* Dan R. Dalton & Catherine M. Dalton, *Women and Corporate Boards of Directors: The Promise of Increased, and Substantive, Participation in the Post Sarbanes-Oxley Era*, 53 BUS. HORIZONS 257, 258, 264 (2010) (suggesting that Sarbanes-Oxley guidelines, specifically those regarding the independent composition of boards of directors' audit committees, led to an increase in gender diversity on boards).

32 Floor Rink, Michelle K. Ryan & Janka I. Stoker, *Influence in Times of Crisis: How Social and Financial Resources Affect Men's and Women's Evaluations of Glass-Cliff Positions*, 23 PSYCH. SCI. 1306, 1306 (2012) (citations omitted).

33 *Id.* See *id.* for a more in-depth critique of gender stereotypes within leadership roles.

34 *See, e.g.*, Dalton & Dalton, *supra* note 31, at 259 fig.1 (showing the percentage of women on *Fortune* 500 boards increased from 8.3% in 1993 to 16.1% in 2009, amounting to an average yearly increase of 0.51% increase pre-2002 and 0.46% post-2002); VIVIAN HUNT, SARA PRINCE, SUNDIATU DIXON-FYLE & KEVIN DOLAN, MCKINSEY & CO., DIVERSITY WINS: HOW INCLUSION MATTERS 15 (2020), https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters [hereinafter HUNT ET AL., DIVERSITY WINS] (noting that female representation on U.S. and U.K. boards has risen from 21% in 2014 to 24% in 2017 to 28% in 2019, while globally remaining consistent between 2017 and 2019 at 24%); *id.* (noting that ethnic minority representation on U.S. and U.K. boards has risen from 13% in 2014 to 14% in 2017 to 17% in 2019, and globally from 14% in 2017 to 16% in 2019); STEPHANIE SONNABEND, MALLI GERO & BETSY BERKHEMER-CREDAIRE, 2020 WOMEN ON BOARDS, GENDER DIVERSITY INDEX: 2020 PROGRESS OF WOMEN CORPORATE DIRECTORS BY COMPANY SIZE, STATE AND INDUSTRY SECTOR 3 (2020), https://2020wob.com/wp-content/uploads/2020/10/2020-GDI-FINAL.pdf (calculating that the percent of Russell 3000 board seats occupied by women has increased from 16.0% in 2017 to 20.4% in 2019 to 22.6% in 2020); PwC, PWC'S 2020 ANNUAL CORPORATE DIRECTORS SURVEY: TURNING CRISIS INTO OPPORTUNITY 11 (2020), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2020-annual-corporate-directors-survey.pdf (stating female representation on S&P 500 boardrooms has increased from 16% in 2009 to 26% in 2019).

35 HUNT ET AL., DIVERSITY WINS, *supra* note 34, at 17.

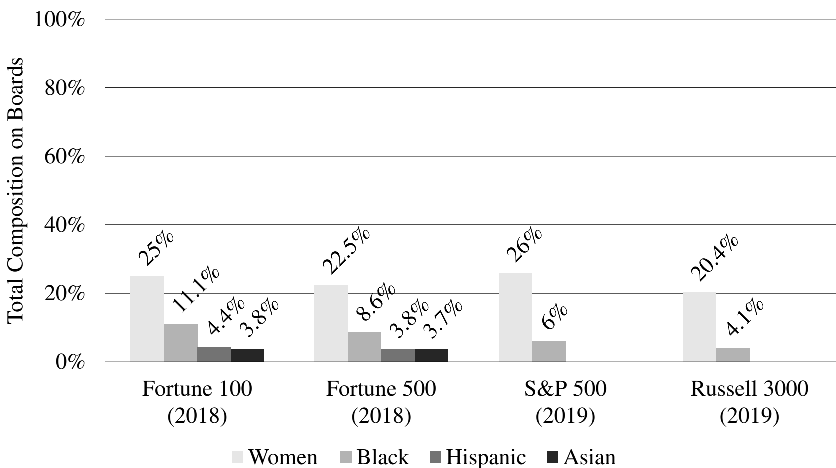
36 *See, e.g.*, VIVIAN HUNT, SARA PRINCE, SUNDIATU DIXON-FYLE & LAREINA YEE, MCKINSEY & CO., DELIVERING THROUGH DIVERSITY 26 (2018) [hereinafter HUNT ET AL., DELIVERING THROUGH DIVERSITY] (finding that while gender diversity on executive

world where corporations hold more power than ever before,[37] that corporations represent all sectors of society remains crucial for both shareholders and community stakeholders.

C. Diversity Today

Consulting firms and corporate governance organizations have started to devote resources towards tracking diversity in corporations. Consequently, they can tally the number of diverse directors and hold corporations accountable for dismal numbers. Some take a broad, global approach, summarizing the current state of corporate governance affairs, changes in diversity and inclusion, and notable trends, while others look at the representation in *Fortune* 100, *Fortune* 500, Russell 3000, and S&P 500 indexes. The following Section presents the most recent accounts of gender diversity and racial diversity on boards of some of the largest companies.

FIGURE 1. DIVERSITY ON BOARDS BY INDEX[38]



teams increased by 2% from McKinsey's 2014 data, ethnic and cultural diversity only increased by 1%); VIVIAN HUNT, DENNIS LAYTON & SARA PRINCE, MCKINSEY & CO., WHY DIVERSITY MATTERS 3 (2015), https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity (finding that while 16% of executive teams are gender-diverse, only 3% of U.S. companies were found to have senior leadership teams that reflect the demographic composition of the country's labor force).

[37] For example, Amazon today is worth more than the GDP of Canada, Russia, and South Korea and is not only an online retailer, but also a leading provider of web services through Amazon Web Services, dominates the logistics industry with its Prime shipping, and supplies groceries to communities via Whole Foods, to name a few of its services. *See* Jeffrey Cole, *The Most Powerful Company in the World? How Big Can Amazon Get?*, CTR. FOR DIGIT. FUTURE (Apr. 21, 2021), https://www.digitalcenter.org/columns/amazon-big.

[38] Data for Hispanic and Asian director diversity were unavailable for the S&P 500 and Russell 3000. For *Fortune* 100 diversity, see DELOITTE, MISSING PIECES REPORT: THE 2018

A few trends are of note. Companies with a larger market capitalization continue to do better when it comes to gender diversity.[39] Of the one hundred largest U.S. companies in the Russell 3000, women hold 29.9% of board seats, while of the one thousand smallest companies in this index, women hold 18.2% of board seats.[40] Likewise, as Figure 1 shows, the percentage of Black, Hispanic, and Asian directors in *Fortune* 100 boardrooms is slightly higher than in *Fortune* 500 boardrooms.[41] Legislation forces companies to perform better on board diversity as well. Companies from California, one of the first states to enact a bill requiring female representation on boards,[42] not only have the most women directors with 349 but also experienced the biggest increase in the percentage of women directors between 2019 and 2020 with a jump of 3.6%.[43] Although companies are slowly making progress in board diversity, trends demonstrate that companies may be taking their feet off the gas. While the number of Russell 3000 companies with zero female directors fell from 22% in 2017 to 7% in 2020,[44] women have started gaining boardroom seats at a slower pace.[45] From 2018 to 2019, the number of Black board mem-

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Board Diversity Census of Women and Minorities on *Fortune* 500 Boards 9, 11 (2019). For *Fortune* 500 diversity, see *id.* at 17, 19. For S&P 500 diversity, see PwC, *supra* note 34, at 11 (noting twenty-six percent female representation on boards); *2019 Fast Stats*, Black Enter., https://www.blackenterprise.com/lists/2019beregistry (last visited Aug. 7, 2021) (noting there were 322 Black directors); Spencer Stuart, 2020 U.S. Spencer Stuart Board Index 10 (2020), https://www.spencerstuart.com/-/media/2020/december/ssbi2020/2020_us_spencer_stuart_board_index.pdf (indicating there were an average of 10.7 board members per S&P 500 company, suggesting a total of 5,350 total board members). For Russell 3000 diversity, see Sonnabend et al., *supra* note 34, at 3 (noting 20.4% female representation on boards in 2019 and an increase to 22.6% in 2020); J. Yo-Jud Cheng, Boris Groysberg & Paul M. Healy, *Why Do Boards Have So Few Black Directors?*, Harv. Bus. Rev. (Aug. 13, 2020), https://hbr.org/2020/08/why-do-boards-have-so-few-black-directors (noting that Black directors comprised 4.1% of Russell 3000 board members).

[39] *See* Heidrick & Struggles Inc., *supra* note 28, at 7.

[40] Sonnabend et al., *supra* note 34, at 3.

[41] *See supra* Figure 1; *see also* Deloitte, *supra* note 38, at 11 (comparing the percentage of board seats held by Black, Hispanic, and Asian directors in the *Fortune* 100 companies with that in the *Fortune* 500 companies).

[42] California Senate Bill No. 826 mandates a diversity quota for Californian-headquartered publicly held corporations. S.B. 826 § 2(a)–(b), 2017–18 Leg., Reg. Sess. (Cal. 2018). The bill requires at least one female director on boards by the end of 2019, and a minimum of two or three female directors on boards of five or six members, respectively, by the end of 2021. *Id.*

[43] Sonnabend et al., *supra* note 34, at 6.

[44] *Id.* at 3.

[45] *See id.* (finding that, in the first six months of 2020, women gained only 36% of new seats, down from 42% in 2019); Spencer Stuart, *supra* note 38, at 3 (finding that minorities gained only 22% of new independent director seats on S&P 500 boards in 2020, compared to 23% in 2019).

bers in S&P 500 companies increased from 308 to 322.[46] But in this same period, the number of S&P 500 companies *without* a Black board member increased from 184 to 193.[47]

There are a few plausible explanations for the slowdown and dampened results. First, diverse directors are being added as new directors, rather than replacing typically white, male incumbent directors. Of the 413 new independent directors added to S&P 500 boards in 2020, a whopping 47% are women and 22% are minorities.[48] This proportion is drastically different than the current makeup of S&P 500 boardrooms.[49] In the Russell 3000, this phenomenon also appears. Of the board seats that women gained, 58% were newly added board seats.[50] Adding diverse directors without replacing incumbent non-diverse directors dampens the percentage of board diversity.[51] Second, companies with more diverse boardrooms might be the ones focusing on expanding diversity even further, while companies with less diverse boardrooms remain stagnant. This could explain why only five percent of the Russell 3000 companies have achieved gender balance in their boardrooms, despite the increase in number of diverse directors.[52] Third, companies appear hesitant to hire diverse candidates as senior executives, as university graduates of color are not promoted to senior executive positions in a level commensurate with white university graduates.[53] Senior executive positions are a common pipeline to board positions.[54] Due to the dearth of executives of color, companies need to expend greater resources to find a director of color and instead may forego that cost altogether by hiring white directors

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46 *2019 Fast Stats*, *supra* note 38.

47 *Id.*

48 SPENCER STUART, *supra* note 38, at 5.

49 *See supra* Figure 1 (showing that in 2019 women comprised 26% of S&P 500 boards, and only 6% of S&P 500 board members were Black).

50 SONNABEND ET AL., *supra* note 34, at 5.

51 For example, if a company with five directors, all of whom are white men, adds a sixth female director, the gender diversity as measured by the ratio of women directors to male directors becomes 1/6 = 16.67%. However, if an incumbent director is replaced with this new female director, gender diversity becomes 1/5 = 20%.

52 *See* SONNABEND ET AL., *supra* note 34, at 3, 5 (determining that a total of 469 companies added 523 new board seats that were filled by women).

53 In the United States, even though the composition of university graduates is 10% Black, 8% Hispanic, 7% Asian, and 68% white, of senior executives, only 4% are Black, 4% are Hispanic, 5% are Asian, while an overwhelming 85% are white. HUNT ET AL., DELIVERING THROUGH DIVERSITY, *supra* note 36, at 14.

54 *See Next Step in Your Career: Position Yourself for a Board*, BOYDEN, https://www.boyden.com/media/next-step-in-your-career-position-yourself-for-a-board-7057253/index.html (last visited Feb. 7, 2020) ("Board positions have traditionally gone to current or former CEOs of larger businesses – people who will impress Wall Street and who already have working relationships with the current board members.").

from the senior executive pool. Fourth, current directors may simply not understand the value of diversity on boards. A disappointing total of "[o]nly 34% of directors believe it is very important to have racial diversity on their board."[55] As Part II will demonstrate, corporate reticence—both historical and current—to increase board diversity is misplaced.

II
The Value of Diversity in Corporate Governance

Traditionally a corporation's value was measured solely by financial performance indicators, such as stock price and accounting metrics.[56] Recent years have seen a partial shift to new metrics, including social, environmental, and diversity measures.[57] This Part includes both the traditional and emerging ways of analyzing corporate performance. After first offering three theories to suggest that studies analyzing the impact of gender diversity can be extrapolated to racial and ethnic diversity, Part II looks at a firm's performance through traditional financial metrics before moving to more contemporary business and social metrics.

A. Theoretical Arguments

To preface this Part, it is important to note that far fewer studies have analyzed the impact of underrepresented racial and ethnic directors on firm value. Most findings highlighted below evaluate gender diversity on boards. However, this Note supposes that conclusions from these studies can translate into other types of board diversity, as the theory underlying the impact of gender diversity on a corporation remains the same and the definition of board diversity in this Note is constrained to equally visible forms of diversity. To guide this assumption, this Section looks at a number of theoretical frameworks—in particular, agency theory, resource dependence theory, and upper echelon theory—that provide insight into why organizations are impacted by board diversity.[58]

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55 PwC, *supra* note 34, at 4. Compare this to the forty-seven percent of directors who believe gender-diverse boards are important. *Id.* at 12.

56 *See* Paine & Srinivasan, *supra* note 1 ("When it comes to corporate financial performance, investors typically look to stock price measures . . . and accounting numbers . . . .").

57 *See id.* ("In addition to measuring financial performance, companies are also being asked to measure their social and environmental performance on various dimensions ranging from diversity and inclusion, to customer privacy and supply chain conditions, to human rights and carbon emissions.").

58 See Siri Terjesen, Ruth Sealy & Val Singh, *Women Directors on Corporate Boards: A Review and Research Agenda*, 17 Corp. Governance: Int'l Rev. 320, 321–24 (2009) for a

Agency theory remains the most prominent and is "most often used by investigators in finance and economics to understand the link between board characteristics and firm value."[59] In its most basic form, agency theory attempts to understand the interactions between agents and their principals. Agency theory identifies that complex firms separate decisionmaking into decision management (e.g., initiation and implementation) and decision control (e.g., ratification and monitoring).[60] In these complex firms, which include publicly traded corporations, an agency problem arises because the agents who make decisions (i.e., the executives) do not also reap the wealth consequences of these decisions and may choose not to maximize shareholders' wealth—leading to a "problem of separation of ownership and control."[61] But the company's board of directors can act as a monitoring mechanism that reduces agency costs by inducing executives to act in the best interest of the corporation and its shareholders.[62] Shareholders thus delegate decision control to the directors. This allows directors to pressure executives into acting properly through ratification and monitoring functions, including firing executives or capping their compensation.[63] Agency theory further suggests that "non-traditional incumbents will be able to exercise power and authority over decision making processes in ways that embed their alternative perspectives into decision outcomes and thereby balance the competing interests of external and internal stakeholders."[64] In other words, increasing the number of female and minority directors—who are clearly non-traditional incumbents as evidenced in Part I[65]—and allowing for their diverse backgrounds and experiences to influence board decisions bolsters the solution to the agency problem. Under the agency theory hypothesis, ideally, these non-traditional

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detailed section on theoretical perspectives beyond the contents of this Note. For a critique on why agency theory and resource dependence theory do not account for gender differences and feminist theories, see Ioanna Boulouta, *Hidden Connections: The Link Between Board Gender Diversity and Corporate Social Performance*, 113 J. Bus. Ethics 185, 186 (2013).

[59] Carter et al., *supra* note 8, at 37.

[60] *See generally* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & Econ. 301, 308 (1983) (describing separation of management and control as a solution to the agency problems of diffuse decision management).

[61] *Id.* at 311–12.

[62] *Id.* at 313.

[63] *Id.*

[64] Alison Cook & Christy Glass, *Do Minority Leaders Affect Corporate Practice? Analyzing the Effect of Leadership Composition on Governance and Product Development*, 13 Strategic Org. 117, 119 (2015).

[65] *See supra* notes 38–52 and accompanying text.

directors should better serve shareholders by acting as superior monitors of executives.

Resource dependence theory looks at "how board capital leads to the provision of resources to the firm"[66] and affects a firm's performance. Within the context of this theory, boards offer "(1) advice and counsel, (2) legitimacy, (3) channels for communicating information between external organizations and the firm, and (4) preferential access to commitments or support from important elements outside the firm."[67] A director's capital consists of two components: "human capital" which comes from a director's own knowledge, skills, experience, and background, and "relational capital" which comes from a director's community and external ties.[68] With more diversity on a board, the range of "human capital" and "relationship capital" also diversifies and increases,[69] leading to the company capturing a greater amount of capital.[70] As a result of the increased capital and resources available to the company, firm performance should increase too.

The upper echelons theory posits that "organizational outcomes can be partially predicted from managerial backgrounds."[71] The first iteration of this theory focused on "observable managerial characteristics": age, tenure, functional background, education, socioeconomic background, and financial investment.[72] These characteristics alter one's approach to "strategic choices" (e.g., product innovation, capital intensity, diversification, integration) that in turn impact "performance" (e.g., profitability, growth, survival).[73] For example, "[f]irms with young managers will be more inclined to pursue risky strategies

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66 Amy J. Hillman & Thomas Dalziel, *Boards of Directors and Firm Performance: Integrating Agency and Resource Dependence Perspectives*, 28 Acad. Mgmt. Rev. 383, 383 (2003). *See generally* Jeffrey Pfeffer & Gerald R. Salancik, The External Control of Organizations: A Resource Dependence Perspective (Stanford Univ. Press 2003) (1978).

67 Hillman & Dalziel, *supra* note 66, at 385–86 (citation omitted).

68 *Id.* at 383, 386.

69 *See generally* Amy J. Hillman, Albert A. Cannella, Jr. & Ira C. Harris, *Women and Racial Minorities in the Boardroom: How Do Directors Differ?*, 28 J. Mgmt. 747, 754 (2002) (finding that white male directors were more likely to be "business experts," while white female directors and African American directors were more likely to be "support specialists" or "community influential" and that white female and African American directors were more likely to have an advance degree than their white male counterparts).

70 *Id.* at 759 ("[F]emale and racial minority directors bring more resources than the additional perspectives and legitimacy provided by their gender and/or race. They bring a variety of occupational expertise and knowledge, advanced education, and accelerated ties to other organizations.").

71 Donald C. Hambrick & Phyllis A. Mason, *Upper Echelons: The Organization as a Reflection of Its Top Managers*, 9 Acad. Mgmt. Rev. 193, 197 (1984).

72 *Id.* at 196.

73 *Id.* at 198.

. . . [and] experience greater growth and variability in profitability from industry averages than will firms with older managers."[74] This theory further suggests that group homogeneity and heterogeneity influence strategic choices, consequently impacting the performance of firms. In particular, during times of "turbulen[ce], especially [in] discontinuous[] environments, team heterogeneity will be positively associated with profitability."[75] While the upper echelons theory is particular to managers (i.e., senior executives), this theory can extend to directors who are also heavily involved in decisionmaking.[76] Thus, upper echelons theory supports evidence that diversity influences directors' strategic choices and brings value to a corporation's performance.

These theories show that it is board heterogeneity and diversity of *any* kind—not just gender diversity—that leads to benefits for a board and its company. Agency theory demonstrates that heterogeneous boards can better tackle the agency problem and balance the competing interests between company executives and shareholders. Resource dependence theory shows that greater diversity on a board results in the firm netting more "human capital" and "relationship capital" as diverse directors often bring varied expertise with respect to intrapersonal and interpersonal matters. And the upper echelons theory illustrates that diverse boards lead to differences in decision-making, which is invaluable during times of change, instability, and innovation. For these reasons, the theories provide a plausible foundation for why research on gender diversity's impact on corporate performance can plausibly be extended to encapsulate the effect of racial and ethnic diversity on a board, as well.

B. *Financial Metrics*

Researchers have long examined whether board diversity leads to an increase in the profitability of firms, using various accounting metrics to measure firm profits. Several have found a positive relationship between board diversity and financial performance. For example, a greater number of women on *Fortune* 500 boards has been found to be associated with greater returns on sales, invested capital, and equity.[77] Diversity in boardrooms was also found to be associated with

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[74] *Id.* at 198–99.

[75] *Id.* at 203.

[76] See Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363, 1389–405 (2002) for a longer discussion on the upper echelons theory and applying it to the performance of boards of directors.

[77] Terry Morehead Dworkin & Cindy A. Schipani, *The Role of Gender Diversity in Corporate Governance*, 21 U. PA. J. BUS. L. 105, 111 (2018) (surveying a 2011 study

a higher return on assets.[78] Companies who have female representation in their boardrooms have a greater stock price performance in comparison to companies with no female board representation.[79] Yet, like most non-experimental observational studies, these findings have limitations.[80] Some simply observed market trends, while others emphasized that correlation does not indicate causation,[81] i.e., a positive relationship between diversity and company performance does not mean that board diversity *creates and leads to* better financial performance.

However, in the early 2000s, academics began to use regression analyses and included a number of control variables to be able to evaluate the impact of board diversity on firm value and assess causality.[82] One of the first—David Carter, Betty Simkins, and W. Gary Simpson's study—included an estimation that accounted for possible endogeneity. In other words, within their calculations, they made sure to account for the fact that "[w]hile board diversity could affect firm value, firm value could also affect board diversity"[83] so that their final estimation revealed the results of the former. Using Tobin's Q[84] as the gauge for firm value, they found that firms with a greater representation of women on boards outperformed those with low representation at a statistically significant level.[85] Firms with more minority directors also had a higher Tobin's Q, but the difference was only slightly significant.[86] Other studies also found a positive relationship between the diversity of boards and firm value as measured by return of assets,

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conducted by Catalyst, a nonprofit that promotes inclusive workplaces for women); *see also* Deborah L. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?*, 39 DEL. J. CORP. L. 377, 384 (2014) (surveying a 2007 Catalyst study).

78 Dworkin & Schipani, *supra* note 77, at 111 (surveying a study conducted by Francesca Lagerberg).

79 MARY CURTIS, CHRISTINE SCHMID & MARION STRUBER, CREDIT SUISSE, GENDER DIVERSITY AND CORPORATE PERFORMANCE 12 (2012).

80 Rhode & Packel, *supra* note 77, at 384–85.

81 Dworkin & Schipani, *supra* note 77, at 107.

82 *See generally* Carter et al., *supra* note 8.

83 *Id.* at 43.

84 Tobin's Q is calculated by dividing the market value of a firm's assets by their replacement value. While some argue that Tobin's Q should not be used as a proxy for firm value, *see* Robert Bartlett & Frank Partnoy, *The Misuse of Tobin's Q*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 2, 2018), https://corpgov.law.harvard.edu/2018/03/02/the-misuse-of-tobins-q, it remains a popular, well-established, and "useful measure for growth opportunities," Leonid Kogan & Dimitris Papanikolaou, *Valuing Possibilities*, KELLOGGINSIGHT (Aug. 1, 2010), https://insight.kellogg.northwestern.edu/article/valuing_possibilities, which is helpful when studying the impact of boards of directors who can significantly impact the growth of companies.

85 Carter et al., *supra* note 8, at 49.

86 *Id.*

return on investment, and Tobin's Q.[87] Evidence from China,[88] Spain,[89] and Australia[90] also demonstrates a positive relationship between gender diversity on boards and financial performance. Looking at longer-term effects, a multi-year McKinsey study showed that companies with boards in the top quartile of gender diversity were 28% more likely to outperform their peers on earnings before interest and taxation at a statistically significant level.[91] An even stronger correlation is found for companies with boards in the top quartile of ethnic diversity, which are 43% more likely to have greater profits.[92]

Notwithstanding the above evidence, other studies show a negative correlation.[93] Charles Schrader, Virginia Blackburn, and Paul Iles found that a higher percent of women on boards was associated with lower returns on sales, assets, income, and equity, even though a positive relationship was found at a statistical level for women managers.[94] And while most studies use pre-existing data, Kenneth Ahern and Amy Dittmar found another way to remove the endogeneity problem that exists with diversity and firm value by using Norwegian data,[95] following Norway's female board representation quota.[96] Their analysis revealed that the mandated quota of female directorship negatively impacted firm value when stock price reaction and Tobin's Q were used as a proxy.[97] Possible explanations for this finding included that the quota led to a "deterioration in the capabilities of the board"

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[87] *See* Rhode & Packel, *supra* note 77, at 385–87 (providing a survey of these studies).

[88] *See* Hisham Farag & Chris Mallin, *The Impact of the Dual Board Structure and Board Diversity: Evidence from Chinese Initial Public Offerings (IPOs)*, 139 J. BUS. ETHICS 333, 347 (2016) (finding a bi-directional relationship between gender diversity and financial performance for Chinese Initial Public Offerings).

[89] *See* Kevin Campbell & Antonio Minguez-Vera, *Gender Diversity in the Boardroom and Firm Financial Performance*, 83 J. BUS. ETHICS 435, 444–47 (2008) (finding a positive relationship between financial performance and gender diversity as measured by percent of women on boards, but not for simply the presence of women on boards).

[90] *See* Ingrid Bonn, *Board Structure and Firm Performance: Evidence from Australia*, 10 J. AUSTRALIAN & N.Z. ACAD. MGMT. 14, 20 (2004) (finding a positive relationship between the ratio of female directors and the market-to-book value ratio).

[91] HUNT ET AL., DIVERSITY WINS, *supra* note 34, at 13.

[92] HUNT ET AL., DELIVERING THROUGH DIVERSITY, *supra* note 36, at 13.

[93] *See* Rhode & Packel, *supra* note 77, at 387–90 (providing a survey of some of these studies).

[94] Charles B. Shrader, Virginia B. Blackburn & Paul Iles, *Women in Management and Firm Financial Performance: An Exploratory Study*, 9 J. MANAGERIAL ISSUES 355, 365 (1997).

[95] *See generally* Kenneth R. Ahern & Amy K. Dittmar, *The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation*, 127 Q.J. ECON. 137 (2012).

[96] *See infra* note 233 and accompanying text.

[97] Ahern & Dittmar, *supra* note 95, at 139–40.

since the new boards were "younger and less experienced" as well as "led firms to increase in size, undertake more acquisitions, increase leverage, and reduce cash holdings."[98]

The mixed results of this Section lead some scholars to conclude that "the empirical research on the effect of board diversity on firm performance is inconclusive, and the results are highly dependent on methodology."[99] Establishing trends solely based on the empirical results is an elusive and impractical task when data sets vary by several factors, importantly company characteristics and definitions of diversity, as exhibited in the Appendix.[100] Instead, a deeper dive into both the data used and the larger implications of hiring diverse directors can shed light onto the varying empirical results and in fact makes the diversity-positive studies more compelling.

First, several of the studies demonstrate a negative impact of diversity, which reveals a clear prior dismissive view towards diverse directors and results in endogeneity that cannot be captured by empirical studies. Schrader, Blackburn, and Iles admitted that the negative relationship between the percent of women directors and firm performance may be attributable to the fact that "women directors are somewhat disadvantaged by the type of board committee assignments they are traditionally given. Women tend to be given assignments that have less instrumental impact for the firm."[101] As a result, female directors placed in these situations are unable to markedly impact the firm and provide benefits associated with diverse directorship. Meanwhile, Ahern and Dittmar found that immediately after Norway's announcement of the female director quota, "the average industry-adjusted stock return for firms with no female directors was -3.54%, compared to -0.02% for firms with at least one female director."[102] This statistically significant difference in stock price reaction suggests that the future influx of female directors led to uncertainty amongst investors and "imposed significant and costly constraints on Norwegian firms,"[103] placing the new female directors in a potentially antagonistic environment. If women or other diverse directors enter a firm and are viewed as an obstruction or treated as incapable of performing the jobs that male directors perform, boards are essentially not operating at their full capacity. In fact, if the presence of diverse directors hinders board functionality through no fault of their own, it

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[98] *Id.* at 141.

[99] Rhode & Packel, *supra* note 77, at 390.

[100] *See infra* Appendix.

[101] Shrader et al., *supra* note 94, at 366.

[102] Ahern & Dittmar, *supra* note 95, at 139.

[103] *Id.* at 160.

explains a finding of negative financial performance, instead of simply no impact.

Second, many empirical studies do not account for the "critical mass" theory in their analysis. This theory has been studied in depth and confirmed by a number of studies;[104] in short, diverse directors' impact on a firm is limited until there are enough diverse directors to be heard and taken seriously. Evidence indicates that benefits begin at two, but the ideal number is three. Schrader, Blackburn, and Iles acknowledge this limitation, noting that their study has "on average only one female per board," and thus, "there is not enough of a 'critical mass' of females at the top management levels to have much of an impact on the firm."[105] Until boards have such a level of diversity, diverse directors are unlikely to make as positive a difference as they would if they were surrounded by other diverse directors. The cornerstone Carter, Simkins, and Simpson diversity study accounts for the "critical mass" problem by eliminating any firms that only had one female or minority director from the analysis "to reduce the possibility of 'token' female or minority directors."[106] As a result, the firms used in their comparison are those where the presence of diverse directorship can truly bring value to a firm. And their study finds just this, as the presence of female directors or the presence of minority directors is positively correlated to firm value, as measured by Tobin's Q, at a statistically significant level.[107] This idea of needing a "critical mass" in order to actualize the benefits of diverse directors also appears to hold true, as boards with two or more female directors and boards with two or more minority directors performed better in corporate governance practices associated with diverse directorship.[108]

Third, it is important to pay attention to "the context in which diversification occurs."[109] Organizational theory shows that "corporate boards are more likely to promote women and people of color . . . when an organization is in crisis."[110] Section I.B demonstrates this trend in the post-Sarbanes-Oxley and post-2008 Financial Crisis world, where corporations focused on bringing women directors aboard. When women and other diverse directors are brought aboard

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[104] *See infra* Section III.C.2 (providing a more detailed discussion about needing a "critical mass").

[105] Shrader et al., *supra* note 94, at 366.

[106] Carter et al., *supra* note 8, at 44.

[107] *Id.* at 51.

[108] *See infra* note 127 and accompanying text.

[109] Rhode & Packel, *supra* note 77, at 391.

[110] NANCY LEONG, IDENTITY CAPITALISTS: THE POWERFUL INSIDERS WHO EXPLOIT DIVERSITY TO MAINTAIN INEQUALITY 77 (2021).

to save a corporation in crisis, they are placed on a "glass cliff"[111] and set up to fail. As a result, many empirical results studying these directors' impacts on firm value do not capture their overrepresentation on struggling companies' boards or the obstacles associated with reviving a precarious company and simply do not control for the "glass cliff" phenomenon. It is worth noting that in the Carter, Simkins, and Simpson study, which shows a statistically significant relationship between board diversity and firm value, firms were matched by size and by industry,[112] likely negating any "glass cliff" effect. Since the comparison firms were matched, it is highly improbable that of two same-sized firms in the same industry one was in crisis while the other was not. Additionally, most of the studies in this Section showing a positive impact of diversity analyzed firms in the major indexes, including *Fortune* and S&P,[113] which are unlikely to include corporations in financial crisis. In essence, studies that accounted for the "glass cliff"—either intentionally by using a matched sample or unintentionally by using a sample of financially successful companies—demonstrate a positive financial impact of diverse directors. Considering inconsistencies with data sets and methodology and the three theories posited above, this Note believes that it is quite conceivable that the studies showing a positive relationship between board diversity and financial performance paint the more accurate picture, since they analyze boards which are truly diverse (i.e., boards with more than one token diverse director).

C. Business Performance

Most companies are able to see the broader non-financial benefits produced by diverse boardrooms, with a majority of directors in PwC's 2020 Annual Corporate Directors Survey[114] concluding that it both "enhances company performance" and "enhances board performance."[115] Diversity in the boardroom "brings unique perspectives

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[111] *See* Michelle K. Ryan & S. Alexander Haslam, *The Glass Cliff: Evidence that Women are Over-Represented in Precarious Leadership Positions*, 16 Brit. J. Mgmt. 81, 83 (2005) (coining the phenomena of "women . . . being preferentially placed in leadership roles that are associated with an increased risk of negative consequences . . . [and] more precarious than those occupied by men" as the "glass cliff"); *see also* Mark Mulcahy & Carol Linehan, *Females and Precarious Board Positions: Further Evidence of the Glass Cliff*, 25 Brit. J. Mgmt. 425, 435 (2014) (looking directly at the relationship between board gender diversity and the glass cliff and finding empirical-backed results to show a glass cliff indeed exists).

[112] Carter et al., *supra* note 8, at 49.

[113] *See infra* Appendix.

[114] PwC's 2020 Annual Corporate Directors Survey includes the responses of 693 U.S. public company directors. See PwC, *supra* note 34, at 34 for additional demographics data on the survey respondents.

[115] *Id.* at 11.

to the room,"[116] allowing for greater marketplace awareness.[117] As the spending power of women and minorities increases, companies will need to understand their consumption needs and adapt accordingly to capture this market.[118] An increased presence of diversity in the boardroom also "increas[es] creativity and innovation."[119] Given that "[a]ttitudes, cognitive functioning, and beliefs are not randomly distributed in the population, but tend to vary systematically with demographic variables . . . an expected consequence of increased cultural diversity in organizations is the presence of different perspectives for the performance of creative tasks."[120]

Additionally, board diversity increases a board's efficiency and productivity,[121] allowing for enhanced problem-solving,[122] more effective decisionmaking,[123] greater transparency, and better communication internally and with the CEO.[124] Diversity enables a board to examine issues in a multitude of ways, guided by the unique perspectives and experiences of each member. A diversity of views allows for "objections and alternatives to be explored more efficiently and solutions to emerge more readily and be adopted with greater confidence."[125] Corporate governance practices are demonstrably better on diverse boards[126]: those with a higher representation of women have

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116 *Id.*

117 Gail Robinson & Kathleen Dechant, *Building a Business Case for Diversity*, 11 Acad. Mgmt. Exec. 21, 26 (1997); *see also* Hunt et al., Delivering Through Diversity, *supra* note 36, at 2.

118 *See* Robinson & Dechant, *supra* note 117, at 26 (highlighting examples of makeup companies employing diverse managers and expanding the skin tone options of their lines to capture diverse consumers).

119 *See id.* at 27; *see also* Cook & Glass, *supra* note 64, at 130 (noting that product innovation increased with a diverse board under a white CEO but did not change under a minority CEO).

120 Robinson & Dechant, *supra* note 117, at 27.

121 Barnali Choudhury, *Gender Diversity on Boards: Beyond Quotas*, 26 Eur. Bus. L. Rev. 229, 234–35 (2015).

122 Robinson & Dechant, *supra* note 117, at 27 (citing Susan E. Jackson, Karen E. May & Kristina Whitney, *Understanding the Dynamics of Diversity in Decision-Making Teams*, *in* Team Effectiveness and Decision Making in Organizations 204, 230 (Richard A. Guzzo & Eduardo Salas eds., 1995)).

123 Hunt et al., Delivering Through Diversity, *supra* note 36, at 2.

124 Cook & Glass, *supra* note 64, at 119.

125 Vivian Hunt, Dennis Layton & Sara Prince, McKinsey & Company, Diversity Matters 12 (2015), https://www.mckinsey.com/insights/organization/~/media/2497d4ae4b534ee89d929cc6e3aea485.ashx.

126 See Bus. Roundtable, *Principles of Corporate Governance*, Harv. L. Sch. F. on Corp. Governance (Sept. 8, 2016), https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance for an in-depth look at best corporate governance practices. Large boards "often bring the benefit of a broader mix of skills, backgrounds and experience." *Id.* A board with fewer inside directors and a greater number of independent directors "is critical to effective corporate governance, and providing objective

larger boards and fewer inside directors; those with a higher representation of minorities have larger boards and more board meetings in a year.[127] The representation of women on boards correlates to "greater compliance with ethical and social standards"[128]: Women directors are better at holding CEOs accountable for bad performance than male directors.[129] The benefits of diversity are interrelated, as firms that have more minority directors also have more female directors, and vice versa.[130]

Diversity in boardrooms creates an impact outside the boardroom, too. It can attract more top talent and create greater employee satisfaction.[131] The labor market increasingly evaluates companies on whether they maintain an inclusive and diverse environment.[132] Companies that excel in this area, particularly in the boardroom, achieve a competitive advantage by "[w]in[ning] the war for talent."[133] Additionally, as our world becomes more globalized, diverse boardrooms enhance these global relationships.[134] Eighty-five percent of board directors maintain that board diversity enhances the company's relationship with its investors.[135] Companies that are diverse at the top level "benefit[] from an enhanced reputation extending . . . to their customers, supply chain, local communities, and wider society" and as a result, are better able to strengthen their "license to operate."[136] Research has also found that companies with diverse boardrooms

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independent judgment that represents the interests of all shareholders is at the core of the board's oversight function." *Id.* More board meetings per year "may help directors stay current on emerging corporate trends and business and regulatory developments." *Id.*

127 Carter et al., *supra* note 8, at 49.

128 Dworkin & Schipani, *supra* note 77, at 113 (surveying a study conducted by Helena Isidro & Márcia Sobral).

129 Cook & Glass, *supra* note 64, at 121 (citing Renée B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. Fin. Econ. 291, 292 (2009)).

130 Carter et al., *supra* note 8, at 50.

131 Hunt et al., Delivering Through Diversity, *supra* note 36, at 2.

132 *See* Robinson & Dechant, *supra* note 117, at 25 ("Companies cited as the best places to work for women and minorities reported an increased inflow of applications from women and minorities, which is evidence of their ability to attract talent."); Hunt et al., Delivering Through Diversity, *supra* note 36, at 23 ("A diverse and inclusive workplace is central to a company's ability to attract, develop, and retain the talent it needs to compete."); Kweilin Ellingrud, *Accelerating Board Diversity*, Forbes (June 26, 2020, 8:44 AM), https://www.forbes.com/sites/kweilinellingrud/2020/06/26/accelerating-board-diversity ("A new survey released by [McKinsey] . . . showed that 39% of survey respondents had turned down an offer or decided not to pursue a new opportunity because of a perceived lack of inclusion.").

133 Hunt et al., Delivering Through Diversity, *supra* note 36, at 23.

134 Robinson & Dechant, *supra* note 117, at 27–28.

135 PwC, *supra* note 34, at 11.

136 Hunt et al., Delivering Through Diversity, *supra* note 36, at 24.

have better reputations.[137] The various proxies for business performance highlighted in this Section demonstrate that board diversity is an invaluable asset that promotes a firm's value.

D. Social Responsibility

Gender diversity on boards is also positively correlated to a firm's performance on social responsibility metrics.[138] Studies have utilized data from the Kinder, Lydenberg, Domini (KLD) social index to analyze the environmental, social, and corporate governance characteristics of companies. Ioanna Boulouta analyzed "strengths" and "concerns" of corporate social performance[139] to find that the greater the number of women directors, the fewer the number of "concerns" or negative business practices, such as controversial lending or investment decisions.[140] Maretno Harjoto, Indrarini Laksmana, and Robert Lee found that greater gender diversity on boards reduces corporate social responsibility concerns and "is positively related to the [corporate social responsibility] components in the community, environment, product, and corporate governance areas."[141]

Stephen Bear, Noushi Rahman, and Corinne Post used the KLD social ratings data to study a company's institutional strength ("positive actions toward diversity and community stakeholders") and technical strength ("positive actions toward consumers, stockholders, and employees").[142] The study showed that the number of women on boards had a positive statistical correlation with technical strength and an even stronger positive correlation with institutional strength.[143] The rationale behind these results harkens back to Section II.C, namely that women directors care about a greater number of issues and focus more on collective decisionmaking than male directors.[144]

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137 *See* Stephen Bear, Noushi Rahman & Corinne Post, *The Impact of Board Diversity and Gender Composition on Corporate Social Responsibility and Firm Reputation*, 97 J. Bus. Ethics 207, 217 (2010) (finding a positive relationship between the number of women on boards and a firm's placement on *Fortune*'s World's Most Admired Companies list).

138 See Kathyayini Rao & Carol Tilt, *Board Composition and Corporate Social Responsibility: The Role of Diversity, Gender, Strategy and Decision Making*, 138 J. Bus. Ethics 327 (2016) for a survey of studies using metrics other than KLD social ratings data that also show a positive relationship between gender diversity and social responsibility.

139 Ioanna Boulouta, *Hidden Connections: The Link Between Board Gender Diversity and Corporate Social Performance*, 113 J. Bus. Ethics 185, 190 (2013).

140 *Id.* at 189, 193.

141 Maretno Harjoto, Indrarini Laksmana & Robert Lee, *Board Diversity and Corporate Social Responsibility*, 132 J. Bus. Ethics 641, 642 (2015).

142 Bear et al., *supra* note 137, at 208.

143 *See id.* at 215 tbl.III (finding a coefficient of 0.421 at $p < 0.01$ for institutional strength and a coefficient of 0.298 at $p < 0.05$ for technical strength).

144 *See id.* at 217 (noting that women bring an increased sensitivity to corporate social responsibility issues and use participative decision-making styles).

In addition, data indicates that "as the number of female directors increases, so does the firm's [corporate social responsibility ratings], suggesting that the contributions women bring to the board in this area are more likely to be considered by the board when the group diversity dynamics move away from tokenism to normality,"[145] giving credence to the "critical mass" argument repeated throughout this Note. While this Section, along with this Part, has shown that board diversity tangibly improves a firm's performance in financial, business, and social responsibility metrics, many still fail to implement better diversity measures at the top. Thus, this next Part seeks to move beyond existing studies by placing the discussion of board diversity within the context of the corporate governance debate of shareholder primacy versus stakeholder models.

III
A Renewed Need for Diversity in Corporate Governance: The Case for Shareholders and Stakeholders

Despite the promising payoffs of board diversity, an expansion has remained slow and prolonged.[146] In order for board diversity to be implemented for more than just the "right reasons" and beyond the level of tokenization, this Note contends that it must be placed within the context of an even larger debate occupying today's corporate governance environment—namely, what is a corporation's purpose? Corporate governance has contended with whether a corporation's sole purpose is to benefit its shareholders, or whether other stakeholders should be considered in its decisionmaking. Section III.A delves into this debate and provides a comprehensive overview of both a shareholder primacy model and a stakeholder approach. Section III.B offers arguments for board diversity through first a shareholder model lens, and second a stakeholder model lens. Section III.C provides recommendations for increasing board diversity in the short run and in the long run.

A. Corporate Governance Models

This Section introduces a debate currently raging throughout corporate boardrooms: whether corporations should serve only shareholders, or other stakeholders as well.

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145 *Id.*

146 *See supra* Sections I.B–C.

1. *Shareholder Primacy*

The landmark case of *Dodge v. Ford*[147] is one of the first and most-cited cases to provide an answer to the long-standing question: What is a corporation's purpose? When the Dodge brothers sued Ford Motor Company for failing to distribute special dividends to shareholders from the company's accumulated surplus, the Michigan Supreme Court held:

> A business corporation is organized and carried on primarily for the profit of the stockholder. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[148]

This view, that corporations exist solely to maximize the wealth of their shareholders, was popularized even further in Milton Friedman's groundbreaking *New York Times* article, "*A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*."[149] As the headline suggests, Friedman advocated that those who act on behalf of a corporation have a responsibility "to make as much money as possible" for the corporation.[150] In other words, Friedman suggested that for a director to act with "social responsibility" in mind was essentially imposing additional taxes on the corporation, beyond taxes already sanctioned by the government. The Business Roundtable strongly endorsed shareholder primacy with the opening line of its 1997 *Statement on the Purpose of a Corporation* reading, "the principal objective of a business enterprise is to generate economic returns to its owners."[151]

Shareholder primacy takes the view that a corporation is a "legal fiction" formed by agreements between shareholders and that its primary purpose is to enhance shareholders' wealth.[152] Shareholder primacy gained traction for a number of reasons, including that it: (1) provided a simpler way to measure company performance by using stock price; (2) encouraged activist hedge funds to purchase shares and pressure management to boost share value; (3) offered an easy way to rate a company's corporate governance best practices; and

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[147] 170 N.W. 668 (Mich. 1919).

[148] *Id.* at 684.

[149] Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at 32.

[150] *Id.* at 33.

[151] BUS. ROUNDTABLE, STATEMENT ON CORPORATE GOVERNANCE 1 (1997).

[152] Paine & Srinivasan, *supra* note 1.

(4) incentivized company executives whose compensation was tied to stocks to maximize share price.[153] These elements of shareholder primacy simultaneously resulted in an intense focus on financial metrics.[154] When companies, or more accurately their directors, take a shareholder primacy view, they are placing a premium on receiving as large of a share price as possible. However, this means that firms often ignore non-financial and non-immediate implications of their decisions, forgoing investments or decisions that provide value outside of share prices or further in time.

2. *Stakeholder Approach*

By the late 1970s and early 1980s, another corporate governance model developed that was the antithesis to the shareholder primacy model. The newly minted stakeholder theory, attributed to R. Edward Freeman, posits "that there are other groups to whom the corporation is responsible in addition to stockholders: those groups have a *stake* in the actions of the corporation."[155] The Stanford Research Institute, who created the term "stakeholder," suggested that corporations would not survive without the support of these stakeholders, i.e., "shareowners, employees, customers, suppliers, lenders, and society."[156] Freeman echoed this sentiment, defining stakeholders as "[a]ny identifiable group or individual on which the organization is dependent for its continued survival."[157] He tied the emergence of stakeholder theory to a rise of corporate social responsibility and strategic management considerations in decisionmaking.[158]

In spite of developments in stakeholder theory, shareholder primacy remained at the forefront of corporate governance in practice. In fact, many believe that shareholder primacy persists because it is deeply embedded within corporate law.[159] Yet, one of the most tan-

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[153] Lynn A. Stout, *On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)*, 36 Seattle U. L. Rev. 1169, 1174–76 (2013).

[154] *See* David A. Katz & Laura McIntosh, *The Long Term, The Short Term, and the Strategic Term*, Harv. L. Sch. F. on Corp. Governance (Sept. 27, 2019), https://corpgov.law.harvard.edu/2019/09/27/the-long-term-the-short-term-and-the-strategic-term ("Hedge funds and other activist investors, equity incentive compensation plans, quarterly earnings releases, and the related but separate issuance of quarterly guidance, are all important factors in promoting short-term-oriented decision-making.").

[155] R. Edward Freeman & David L. Reed, *Stockholders and Stakeholders: A New Perspective on Corporate Governance*, 25 Cal. Mgmt. Rev. 88, 89 (1983).

[156] *Id.*

[157] *Id.* at 91.

[158] *See id.* at 90–91 (pointing to the Harvard Business School's study on corporate social responsibility and the Wharton School's study on management theory).

[159] *See, e.g.*, Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 Minn. L. Rev. 1951, 1967 (2018) (citing corporate finance, takeovers, and managerial

gible impacts of stakeholder theory was the emergence of "antitakeover legislation" in the 1980s and 1990s that "explicitly allowed directors to consider the interests of other constituencies when making a decision on an acquisition of the company, or more generally, on any issue."[160] The last few years have seen a renewed energy behind stakeholder theory. Academics, businesspeople, and politicians alike have started to seriously turn towards stakeholder theory as people begin to grapple with the harms imposed by an unfettered drive towards profit maximization that shareholder primacy invokes.[161]

Worldwide, countries and organizations alike have started endorsing a stakeholder approach. In the United Kingdom and France, corporate code and statutes have unambiguously indicated a move towards directors considering both stakeholders and long-term impacts.[162] The World Economic Forum has promoted stakeholder theory through its publication of the *Davos Manifesto 2020*[163] and Martin Lipton's renowned *The New Paradigm*.[164] In a stunning

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decisionmaking as promoting profit maximization); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 26 (Del. Ch. 2010) (finding that "directors of Delaware corporations are fiduciaries of the corporations' stockholders"); *see also* Jeff Schwartz, *De Facto Shareholder Primacy*, 79 MD. L. REV. 652 (2020) (discussing the phenomena of "de facto shareholder primacy," where activist hedge funds use security laws as a "powerful lever of shareholder primacy" to their advantage).

160 Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 105 (2020).

161 *See* Edward B. Rock, *For Whom is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363, 363–67 (2021) (capturing the positions of Oxford economist Colin Mayer, famed lawyer Martin Lipton, BlackRock CEO Larry Fink, and Senators Elizabeth Warren and Bernie Sanders, among others).

162 Companies Act 2006, c. 46 § 172(1) (UK), https://www.legislation.gov.uk/ukpga/2006/46/part/10/chapter/2/crossheading/the-general-duties; FIN. REPORTING COUNCIL, THE UK CORPORATE GOVERNANCE CODE 1, 4 (2018); *see* PLAN D'ACTION POUR LA CROISSANCE ET LA TRANSFORMATION DES ENTREPRISES 70 (2019) ("Unlike multiple other European countries, France does not provide a [shareholder foundation] status under which a foundation is authorized to act as a long-term corporate shareholder." (translated from the French)).

163 *See generally* Klaus Schwab, *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution*, WORLD ECON. F. (Dec. 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution ("The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large.").

164 *See generally* MARTIN LIPTON, STEVEN A. ROSENBLUM, SABASTIAN V. NILES, SARA J. LEWIS & KISHO WATANABE, INT'L BUS. COUNCIL OF WORLD ECON. F., THE NEW PARADIGM: A ROADMAP FOR AN IMPLICIT CORPORATE GOVERNANCE PARTNERSHIP BETWEEN CORPORATIONS AND INVESTORS TO ACHIEVE SUSTAINABLE LONG-TERM INVESTMENT AND GROWTH 1 (2016), https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf ("[T]he New Paradigm recalibrates the relationship

rebuke of its previous 1997 statement, the Business Roundtable released a new *Statement on the Purpose of a Corporation* in 2019 that echoed the tenets of a stakeholder approach. Hundreds of CEOs acknowledged that although "individual companies serve[] [their] own corporate purpose[s], we share a fundamental commitment to *all* of our stakeholders."[165] An explicit pledge is made to: provide value to customers, advance employees, treat suppliers equitably, protect the community and its environment, and create long-term value for shareholders.[166] The Business Roundtable's change of position is exemplified by referencing shareholders in its latest commitment and a clear remark promoting the long-term prosperity and sustainability of companies, i.e., long-termism. This statement is one of the loudest and most vital indications that corporations and directors are beginning to act with environmental, societal, and governance implications in mind. Although the tide seems to be turning towards the stakeholder model, it is unlikely shareholder primacy will ever truly fade into obsolescence, calling for an analysis of board diversity accounting for both models.

B. Viewing the Value of Board Diversity Through a Corporation's Purpose

This Section seeks to show that board diversity is advantageous to a corporation, regardless of whether one takes a shareholder primacy view or a stakeholder primacy view. It is important to demonstrate the benefits of diverse directors in *both* of these models, as the dominant corporate governance theory explaining what a corporation's purpose is, and consequently what guides a board, fluctuates between the two. Furthermore, each of these theories have a number of ardent skeptics in both academia[167] and the corporate world.[168] For any demonstrable change to occur, both sides of the debate must be addressed.

1. Benefits for Shareholders and Corporations

Pushing for an increase in board diversity can be a tricky path to proceed down, if not approached in the proper manner. As one execu-

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between public corporations and their major institutional investors and conceives of corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value and resist short-termism.").

[165] BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (2019), https://opportunity.businessroundtable.org/ourcommitment.

[166] *Id.*

[167] *See generally* Bebchuk & Tallarita, *supra* note 160, at 108 (arguing that despite its appeal, stakeholderism would be "detrimental for shareholders, stakeholders, and society alike").

[168] *See infra* note 207 and accompanying text.

tive puts it, "[t]here is real debate between those who think we should be more diverse because it is the right thing to do and those who think we should be more diverse because it actually enhances shareholder value. Unless we get the second point across . . . we're only going to have tokenism."[169] This Section does not focus on the first normative argument, but instead addresses the second point: Diverse boardrooms can promote shareholders' wealth and create tangible benefits for the corporation.

Section II.B provided an account of studies that have analyzed the impact of board diversity on firm value. The empirical relationship between board diversity and firm value has varied between studies, in large part due to factors underscored in the Appendix[170] and other facets of diverse directorship, which are not always accounted for in experiments.[171] Despite this purported uncertainty, there is still compelling evidence that board diversity is positively correlated with a benefit to shareholders' wealth.[172] In some circumstances, the appointment of female directors causes an immediate increase in share value.[173] Firms with gender-diverse boards are able to minimize the risk of a stock price crash[174] and even demonstrate share price increases during times of economic instability.[175] Many of the business performance and social responsibility benefits of board diversity summarized in Part II[176] can lead to increased stock price.[177] And while

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[169] Carter et al., *supra* note 8, at 34 (quoting Karen J. Curtin, executive vice president of Bank of America).

[170] *See infra* Appendix.

[171] *See supra* notes 101–13 and accompanying text.

[172] *See supra* Section II.B.

[173] *See* Terjesen et al., *supra* note 58, at 330 (finding a 2.3% increase in the two days following appointment of a female director between 1988 and 2001). *But see* Daniel Greene, Vincent J. Intintoli & Kathleen M. Kahle, *Do Board Gender Quotas Affect Firm Value? Evidence from California Senate Bill No. 826*, 60 J. Corp. Fin. 1, 2, 7–11 (2020) (finding a 1.2% decrease in stock market value following the *announcement* of California's Senate Bill No. 826 which was "likely driven by the mandated quota, which constrains board composition and imposes additional costs on the firm," especially on those firms who "may struggle to find female candidates if they currently fall short of SB 826 mandates and operate in industries where supply [of female director candidates] is limited," rather than as an indication that the presence of female directors causes a decrease in firm value).

[174] Khalil Jebran, Shihua Chen & Ruibin Zhang, *Board Diversity and Stock Price Crash Risk*, 51 Rsch. Int'l Bus. & Fin., Jan. 2020, at 9; *see also* Hambrick & Mason, *supra* note 71, at 203 (proposing that, "[i]n turbulent, especially discontinuous environments, team heterogeneity will be positively associated with profitability").

[175] Terjesen et al., *supra* note 58, at 330.

[176] *See supra* Section II.B–D.

[177] Bear et al., *supra* note 137, at 217 ("The positive impact of women on boards can improve ratings for CSR [corporate social responsibility] which can, in turn, enhance corporate reputation and positively impact financial performance, institutional investment, and share price . . . ." (citation omitted)).

some studies show that diverse boards have a negative impact on share price, evidence indicates this is often due to institutional investors with a negative bias against diverse directors.[178] As diversity becomes more commonplace in corporate boardrooms, this negative bias should disappear, allowing for the positive impact of diverse directorship to further actualize.[179]

Increasing the diversity of boards can serve as a powerful tool to fight against hedge fund activism. Hedge fund activism has increased dramatically in the past decade.[180] Hedge fund activists frequently rely on the dominance of shareholder primacy when launching their campaigns and use an "aggressive approach . . . [to] purchase stakes in target firms and demand that they make changes to immediately increase stock prices."[181] These campaigns built around maximizing profits for shareholders are often accomplished by securing a number of board seats, replacing executive teams, and conducting corporate restructuring.[182] While hedge fund activism can be beneficial in certain contexts, including when it encourages board diversity,[183] it can also be quite damaging to a company, especially when it engages in short-termism, i.e., focusing solely on the immediate economic prosperity of a company. An intense focus on increasing share price as quickly as possible is attributed to the decline in the number of public companies.[184] Shareholders and incumbent directors who want to preserve a corporation's longevity and promote shareholders' wealth beyond the short-sighted attacks of hedge fund activists are better served by a board with more diverse directors.

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[178] *See generally* Frank Dobbin & Jiwook Jung, *Corporate Board Gender Diversity and Stock Performance: The Competence Gap or Institutional Investor Bias?*, 89 N.C. L. Rev. 809 (2011) (finding that while female directors had a negative impact on stock price, they did not have any impact on profits, suggesting a bias from institutional investors). *See also supra* notes 101–03.

[179] *See infra* Section III.C.2.

[180] *See* Assaff Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. Rev. 971, 977–79 (2019) (discussing the rise of hedge fund activism and its effect on public companies).

[181] Schwartz, *supra* note 159, at 655–56.

[182] Aniel Mahabier & Folorunsho Atteh, *2020 Activist Investor Report*, Harv. L. Sch. F. on Corp. Governance (Aug. 1, 2020), https://corpgov.law.harvard.edu/2020/08/01/2020-activist-investor-report.

[183] *See infra* notes 189–96 and accompanying text.

[184] *See* Stout, *supra* note 153, at 1170–80 ("[T]he desire to avoid activist hedge funds and shareholder-value thinking has been cited as a reason why many companies are going private or staying private.").

For one, companies with more dispersed shareholders are significantly more likely to have female directors.[185] In other words, companies with more female directors tend to have their shares spread out across more minority shareholders, rather than held mainly by majority shareholders. This correlation should be of interest to companies who are interested in fending off activist hedge funds, and it can be interpreted in two ways. First, in terms of pure probability, if shares are more dispersed, they are more likely to be held by people and organizations who represent a cross-section of that corporation's community. Thus, it is quite plausible that these shareholders will pressure the corporation to have diverse directors who are representative of the holders.[186] In extreme situations, this pressure can result in shareholder proposals and lawsuits, as discussed below. Second, companies with more diverse directors may have a corporate structure that preemptively provides them with an upper hand to battle activists in a proxy fight. In order to secure votes, activists have to take their case to a larger number of investors, often through media campaigns.[187] Again, in terms of probability, as shareholders remain more dispersed, activists need a larger number of investors to buy into their campaign and vote in accordance with them during the proxy fight. If the activist decides instead to buy shares to secure votes, having more dispersed shareholders can make the proxy fight drastically more expensive. "[D]ispersed shareholders free-ride ex ante by selling their shares only if the takeover premium incorporates the expected post-takeover gains,"[188] so when shares are held by a large number of these free-riding dispersed shareholders, proxy fights become more costly for an activist to secure the shares needed to win the proxy battle. Companies should take note of the correlation between diverse directorship and dispersed shareholders, as it benefits the company by pro-

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[185] Helen Kang, Mandy Cheng & Sidney J. Gray, *Corporate Governance and Board Composition: Diversity and Independence of Australian Boards*, 15 Corp. Governance: Int'l Rev. 194, 198, 203 (2007).

[186] While having dispersed shareholders may make it more difficult for shareholders to monitor and collectively organize to demand diverse directors, there is still a benefit to having a greater number of voices who can raise awareness to the need for diverse directorship. In fact, several of the lawsuits discussed below are filed by individual investors on behalf of the corporation, rather than by larger equity investors.

[187] Pershing Square's Bill Ackman was forced to appear on CNBC on an almost daily basis in order to plead to investors to back Pershing Square in their proxy fight against Target's board and management. Despite these efforts, Pershing Square ultimately lost this proxy fight. Bill George & Jay W. Lorsch, *How to Outsmart Activist Investors*, Harv. Bus. Rev. (May 2014), https://hbr.org/2014/05/how-to-outsmart-activist-investors.

[188] Mike Burkart & Samuel Lee, *Activism and Takeovers*, Harv. L. Sch. F. on Corp. Governance (Feb. 20, 2018), https://corpgov.law.harvard.edu/2018/02/20/activism-and-takeovers.

tecting it from harmful or unwanted proxy fights or tender offers since changes in control become less likely with a dispersed shareholding. As a result, incumbent directors are able to focus on providing longer-term value to the company and its shareholders.

As noted above, hedge fund activism is not always bad. Recently, some hedge funds have pushed for diverse boardrooms. Take for instance BlackRock, who has "voted against director elections due to inadequate gender diversity on the board."[189] State Street has taken their negative vote campaigns even further, threating to launch proxy fights to get diversity in boardrooms: "In the event that companies fail to take action to increase the number of women on their boards, despite our best efforts to actively engage with them, we will use our proxy voting power to effect change."[190] Its bold strategy to improve gender diversity on boards leverages voting threats against the nominating committee, governance committee, or the entire board.[191] These campaigns and threats are no joke; institutional investors have voted against hundreds of directors.[192] But they do work—nearly forty-one percent of the companies that BlackRock cast negative votes against in director elections due to a lack of diversity improved their board diversity within a year.[193] Other research shows "campaigns by BlackRock, State Street, and Vanguard led firms to add at least 2.5 times as many female directors in 2019 as they had in 2016 and increased a female director's likelihood of holding a key position on the board."[194] However, negative vote campaigns and proxy fight threats are costly for corporations—they consume time and resources that can be expended elsewhere to enhance shareholder value.[195]

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[189] BLACKROCK, *supra* note 4, at 11.

[190] STATE STREET GLOBAL ADVISORS, STATE STREET GLOBAL ADVISORS' GUIDANCE ON ENHANCING GENDER DIVERSITY ON BOARDS 2 (2019), https://www.ssga.com/investment-topics/environmental-social-governance/guidance-on-enhancing-gender-diversity-on-boards.pdf.

[191] *Id.*

[192] *See* Paula Loop, Catherine Bromilow & Leah Malone, *The Changing Face of Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 1, 2018), https://corpgov.law.harvard.edu/2018/02/01/the-changing-face-of-shareholder-activism (finding that State Street voted against 400 companies); EY CTR. FOR BD. MATTERS, FIVE TAKEAWAYS FROM THE 2019 PROXY SEASON 3 (2019), https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-cbm-2019-proxy-season-preview.pdf (determining that director opposition votes for all-male boards compared to boards with one-fifth female boards in S&P 1500 companies was 24% versus 5% for nominating and governance committee chairs, 18% versus 4% for nominating and governance committee members, and 8% versus 3% for other directors).

[193] BLACKROCK, *supra* note 4, at 11.

[194] *Id.* at 19.

[195] *See, e.g.*, Mark Fahey, *Yahoo Will Likely Pay Millions for Proxy Fight*, CNBC https://www.cnbc.com/2016/04/14/yahoo-will-likely-pay-millions-for-proxy-fight.html (Apr.

Shareholders and incumbent directors alike will want to avoid these costly campaigns. This can be done by preemptively selecting diverse directors as a safeguard. If boards have a diverse composition to start with, corporations give these activist investors much less fuel: one less reason to vote against the board, one less reason to launch a campaign that may cause instability within the corporation, especially if campaigns are viewed as a signal for other institutional and governance problems, and one less reason to divert resources from other share price maximizing efforts.[196]

Individual shareholders, along with institutional shareholders, are also pushing for diversity within the boardroom through vocal and visible acts. A number of recent shareholder proposals are aimed at increasing board diversity or requiring companies to report on it.[197] Shareholders have started to take more aggressive actions as well. Several shareholders have sued due to their corporation's lack of board diversity. As of the end of 2020, eight shareholder derivative suits had been filed—seven in California[198] and one in the District of Columbia[199]—against Cisco, Danaher, Facebook, Gap, Monster Beverage, NortonLifeLock, Oracle, and Qualcomm and numerous present and former directors of these well-known companies. The lengthy complaints

> [a]ccuse directors of misrepresenting company commitment to diversity in proxy statements to avoid market scrutiny and mislead shareholders . . . [and] also allege that the directors have breached their fiduciary duties of candor, good faith, and loyalty by repeat-

14, 2016, 2:52 PM) (noting how "companies can spend millions on lawyers, solicitation firms and other costs like mailings to shareholders").

[196] *See* BLACKROCK, *supra* note 4, at 19 (noting negative vote campaigns "send a powerful signal of concern to boards and management" and "tend to focus the minds of board members and lead companies to address the governance and sustainability risk management concerns").

[197] *See* Loop et al., *supra* note 192 (specifying board diversity as an example of the 453 shareholder proposals on social and political issues in the 2017 proxy season); EY CTR. FOR BD. MATTERS, CORPORATE GOVERNANCE BY THE NUMBERS (2020) https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-2020-monthly-cgbtn-june.pdf (determining that shareholder proposals to increase and report board diversity received thirty-three percent average support in the first half of 2020).

[198] *See* Complaint, City of Pontiac Gen. Emps.' Ret. Sys. v. Bush, No. 20-cv-06651 (N.D. Cal. Sept. 23, 2020) (Cisco); Complaint, Ocegueda v. Zuckerberg, No. 20-cv-04444 (N.D. Cal. July 2, 2020) (Facebook); Complaint, Lee v. Fisher, No. 20-cv-06163 (N.D. Cal. Sept. 1, 2020) (Gap); Complaint, Falat v. Sacks, No. 20-cv-01782 (C.D. Cal. Sept. 18, 2020) (Monster Beverage); Complaint, Esa v. Pilette, No. 20-cv-05410 (N.D. Cal. Aug. 5, 2020) (NortonLifeLock); Complaint, Klein v. Ellison, No. 20-cv-4439 (N.D. Cal. July 2, 2020) (Oracle); Complaint, Kiger v. Mollenkopf, No. 20-cv-01355 (S.D. Cal. July 17, 2020) (Qualcomm).

[199] *See* Complaint, Markarian v. Joyce Jr., No. 20-cv-02846 (D.D.C. Oct. 6, 2020) (Danaher).

edly making false assertions about the company's commitment to diversity and by failing to act in the company's best interest, which includes maximizing corporate value by attaining diverse leadership.[200]

The suits face a challenging uphill battle of pinpointing and then calculating damages caused by the lack of board diversity. And in fact, as of October 2021, a number of these suits have been dismissed.[201] Despite the plethora of studies showing that diverse boards lead to increased firm profits,[202] legal scholars believe that this evidence likely "does not appear to provide a legal basis for allowing a court to interfere with a board's business judgment about how to best address issues related to diversity."[203] Nonetheless, the quantity of shareholder derivative suits targeted at notable companies indicates a larger trend of growing shareholder frustration with the lack of diversity in boardrooms. It demonstrates that shareholders possess an acute awareness of "companies as 'Old Boy's Club[s]' engaging in 'tokenism' who merely pay 'lip service' to create a 'veneer' of commitment to diversity."[204] Similar to negative vote campaigns and proxy fight threats, defending shareholder derivative suits is expensive. Directors and executives have to divert their time and energy to fending off these suits, the company has to pay for costly lawyers, and the company may incur a loss of goodwill and brand valuation. Undeniably, such a distraction is damaging to both tangible and intangible assets and may, directly or indirectly, result in a decrease in share price, becoming costly for both the corporation and its shareholders. Instead of acting in a manner that frustrates shareholders, companies can simply increase diversity on boards to save themselves from costly repercussions later on.

Companies need to increase diversity at all levels, but especially in the boardroom, to survive in today's climate. For those who passionately advocate for a shareholder primacy model, this Subsection provided evidence that increasing diversity preserves and enhances

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[200] Alexis Coll-Very, Deborah S. Birnbach & Jade T. White, *Goodwin Procter Discusses Shareholder Suits to Increase Board Diversity*, CLS Blue Sky Blog (Nov. 17, 2020), https://clsbluesky.law.columbia.edu/2020/11/17/goodwin-procter-discusses-shareholder-suits-to-increase-board-diversity.

[201] Kevin LaCroix, *Two More Board Diversity Lawsuits Dismissed*, D&O Diary (Sept. 2, 2021), https://www.dandodiary.com/2021/09/articles/shareholders-derivative-litigation/two-more-board-diversity-lawsuits-dismissed (noting that suits against Danaher, Facebook, Gap, and NortonLifeLock have been dismissed).

[202] *See supra* note 92 and accompanying text.

[203] Samantha Burdick, Bianca DiBella, Pamela Palmer, Alexandra Peurach & Howard Privette, *A New Wave of Board Diversity Derivative Litigation*, JD Supra (Oct. 21, 2020), https://www.jdsupra.com/legalnews/a-new-wave-of-board-diversity-89301.

[204] Coll-Very et al., *supra* note 200.

shareholder value. Greater diversity in a boardroom benefits a corporation by enabling it to protect itself against activist hedge funds who pose a threat to the company's longevity. It can also preemptively frustrate the efforts of well-intentioned hedge funds, institutional investors, and shareholders who desire board diversity but whose actions end up quite costly for the corporation and may disrupt corporate stability.

2. *Benefits for Stakeholders and Society*

The advantages provided by diverse directors are easier to observe as analyzed through a stakeholder lens. This Subsection does so by first looking at how diverse directors impact overall positions on the broader environmental, social, and governance framework, before delving into individual metrics. It also explores how diverse boardrooms create better board practices, by hiring both diverse directors and promoting better board practices, benefitting not just the company, but its stakeholders as well. Next, it looks at how diverse boards are advantageous to arguably one of the most important stakeholders—employees. Lastly, this Subsection concludes by emphasizing that board diversity furthers long-termism—an important tenet of the stakeholder model.

Stakeholder theory is often analyzed through an environmental, social, and governance framework,[205] as these metrics capture an array of topics that impact stakeholders.[206] While directors are starting to realize the importance of environmental, social, and governance issues, over half of boards still do not bring these issues up during board meetings.[207] It is essential for directors to bring these matters to light so that the impact of a company on all of its stakeholders can be evaluated. Female directors have been found to simply do a better job at this. Not only do they broaden a board's agenda during meetings, but they are also more likely to bring up items

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[205] *See* Ira Kay, Chris Brindisi & Blaine Martin, *The Stakeholder Model and ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 14, 2020), https://corpgov.law.harvard.edu/2020/09/14/the-stakeholder-model-and-esg ("If the stakeholder model represents an emerging model for the *strategic* vision of a company, ESG (Environmental, Social, and Governance) metrics can be used to assess and measure company performance and its relative positioning on a range of topics relevant to the broader set of company stakeholders.").

[206] Such topics include: (1) environmental: carbon and climate, natural resources, waste and toxicity, management of environmental risk; (2) social: human rights, labor, health and safety, diversity and inclusion, product safety, quality and brand, community engagement, partnerships; and (3) governance: board composition, ethics and compliance, general corporate governance, risk management, and mitigation. *Id.*

[207] *See* PwC, *supra* note 34, at 8 ("In 2020, just under half of directors (45%) say that ESG issues are regularly a part of the board's agenda, up from just 34% in 2019.").

involving multiple stakeholders[208] and to find a link between the company's strategy and environmental, social, and governance issues.[209] In sharp contrast, only a third of male directors agree with how much time is devoted to environmental and sustainability issues.[210] Meanwhile, two-thirds of female directors believe the same.[211] If stakeholders are to be considered when thinking about a corporation's purpose, the presence of diversity in boardrooms is vital so that environmental, social, and governance factors are accounted for in decisionmaking.

On individual environmental, social, and governance issues, diverse directors simply care more. In annual director surveys, female directors were more likely than male directors to agree that their company should consider climate change, human rights, resource scarcity, and social movements in its strategy.[212] The issues that directors deem relevant to their role differ, too. Black directors prioritize social issues like equal rights for women, economic justice, and unemployment, whereas white directors prioritize economic topics including the national budget deficit and energy costs.[213]

And studies of environmental, social, and governmental metrics indicate that diverse directors' actions support their beliefs. Gender-diverse boards scored better than non-gender-diverse boards on ISS-oekom Corporate Rating scores,[214] in particular on the environmental score; the social score; and the combined environmental, social, and governance score.[215] This suggests that firms with board diversity have incorporated better sustainability practices. Furthermore, the longer a firm has gender diversity on its board, the better its sustainability practices become.[216] Firms' charitable contributions also increase with the rise in number of female and ethnic minority directors.[217] When it

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208 Rhode & Packel, *supra* note 77, at 396 (citation omitted).

209 *See* PwC, *supra* note 34, at 8 (uncovering that 60% of female directors see a link compared to 46% of male directors).

210 PwC, PwC's 2019 Annual Corporate Directors Survey: The Collegiality Conundrum: Finding Balance in the Boardroom 19 (2019).

211 *Id.*

212 PwC, *supra* note 34, at 22.

213 Cheng et al., *supra* note 38.

214 "The ISS-oekom Corporate Rating provides a highly relevant and material assessment of a company's environmental, social and governance performance." ISS-oekom, Methodology: ISS-oekom Corporate Rating 1 (2018).

215 Christina Banahan & Gabriel Hasson, *Across the Board Improvements: Gender Diversity and ESG Performance*, Harv. L. Sch. F. on Corp. Governance (Sept. 6, 2018), https://corpgov.law.harvard.edu/2018/09/06/across-the-board-improvements-gender-diversity-and-esg-performance.

216 *See id.* (indicating an improvement from year one to year three to year five).

217 Harjoto et al., *supra* note 141, at 644 (citation omitted).

comes to governance, companies with more diverse directors are found to have more effective onboarding processes.[218]

Looking in particular at the governance issue of board composition, although perhaps a self-reinforcing concept, the presence of diverse directors will lead to greater future diversity in board composition. Female directors perceive that board diversity enhances board performance and company performance two times more than male directors do, which is likely to incentivize them to diversify a board's composition.[219] Racially diverse boards are more likely to prioritize diversity in their company than non-racially diverse boards.[220] These perceptions and preferences result in demonstrable actions towards expanding board diversity. Firms with two or more female directors are more likely to use search consultants during a hiring process,[221] which leads to a greater number of diverse candidates being considered and improves the likelihood of board composition diversifying.[222] Boards with two or more racially or ethnically diverse directors consider an average of 1.0 racially or ethnically diverse candidates for the board and an average of 3.9 candidates total.[223] Compare this to boards with no directors of color who consider an average of 0.2 candidates of color and an average of 2.9 candidates total for the open board seat.[224] As the number of diverse directors increases on a board, their benefits become realized to their maximum potential.

The business performance and social responsibility benefits, discussed in Part II, provide direct and indirect value to stakeholders.[225] From Part II, it was clear that diverse directors create efficient, productive, and innovative boardrooms, which can better tackle complex, pressing issues facing our world today, such as climate change, social injustice, and inequality. A variety of views represented in diverse boardrooms ensures that an array of stakeholders' perspectives is given due consideration in company strategy. The positive association between board diversity and corporate social responsibility ratings also indicates that heterogeneous boards create more positive outputs for stakeholders. For companies that require a greater need for stake-

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[218] *See* Cheng et al., *supra* note 38 (suggesting that both training for new directors and integrating new members is more effective as the diversity of a board increases).

[219] PwC, *supra* note 34, at 23.

[220] Cheng et al., *supra* note 38.

[221] Terjesen et al., *supra* note 58, at 329.

[222] *See* Cheng et al., *supra* note 38 (noting that Black directors were more likely to have been recruited by a search firm than white directors); *see also infra* Section III.C.1.

[223] Cheng et al., *supra* note 38.

[224] *Id.*

[225] *See supra* Sections II.B–D.

holder management, the impact of diverse boards is even stronger.[226] This is promising for firms who may be in the middle of an identity crisis between a shareholder primacy model and stakeholder approach.

An increased presence of diversity on boards also leads to "role model benefits" for employees. Diverse directors open up new networking, mentorship, and sponsorship opportunities for employees who may have felt alienated from and unrepresented by those in the boardroom prior. When women, people of color, and other underrepresented employees see someone who shares their identity in a boardroom, they often feel inspired.[227] As a result of these "role model benefits," not only do diverse employees believe that such an accomplishment is possible for them too, but the recruitment and retention of such diverse employees improves as well.[228] This is evident in *Fortune* 500 companies where the number of female directors is positively correlated with the number of other high-ranking female managers and employees.[229]

One of the strongest arguments in favor of stakeholder theory is that it promotes long-termism and the prolonged sustainability of a company. A McKinsey study has found that gender-diverse companies are twenty-seven percent more likely to provide superior long-term value creation.[230] Research by FCLTGlobal attributes greater gender diversity on boards, with an eight percent explanatory power, to the creation of higher long-term value.[231] The only factors with a higher explanatory power than greater board gender diversity are greater fixed investment and higher research quotient.[232] Every advantage of board diversity can contribute to long-term value creation, which is why it is essential to maximize diversity on boards. Companies with long-term sustainability are better able to fulfill a corporation's purposes of providing value for shareholders and protecting the interests of community stakeholders; it is essential to promote their existence. Creating more diverse boards does just that.

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[226] *See* Harjoto et al., *supra* note 141, at 657 ("The results suggest that diverse boards play a more significant role in stakeholder management in firms operating in an environment that requires high intensity of stakeholder management.").

[227] *See* Terjesen et al., *supra* note 58, at 331 (noting that when there was a female director on a board, sixty-six percent of women in that company were found to be optimistic about the trajectory of their career).

[228] *Id.*

[229] *Id.*

[230] Hunt et al., Delivering Through Diversity, *supra* note 36, at 10.

[231] FCLTGlobal, Predicting Long-Term Success For Corporations and Investors Worldwide 8 (2019).

[232] *Id.*

C. Recommendations to Increase Board Diversity

This Note has aimed to provide concrete evidence and reasoning for the urgency of diversity in every boardroom. This Section looks to the future: it offers lawmaking bodies and corporations recommendations to assist in expanding diversity in the short run and long run. The objective of the short-run recommendations is simply for boards to have one diverse director. The long-run recommendations intend to offer ways in which the benefits of board diversity can become fully realized.

1. In the Short Run

Legislative and regulatory acts targeted towards increasing board diversity have gained momentum. Some have imposed a diversity quota while others have enforced disclosure requirements. In 2003, Norway became the first country to legally require female representation on boards; listed company boards needed to be composed of forty percent female directors by 2008.[233] Other countries, including Belgium, France, Italy, Austria, Portugal, and Germany, have mandated board diversity quotas too.[234] The United States has fallen behind its peer countries. The most comprehensive federal requirement, adopted by the Securities and Exchange Commission, mandates that companies "disclose if and how diversity is considered as a factor in the process for considering candidates for board positions."[235] In August 2021, Nasdaq received approval from the Securities and Exchange Commission to mandate the disclosure of board-level diversity statistics for most Nasdaq-listed companies.[236] Congress tried to push the Improving Corporate Governance Through Diversity Act of 2019[237] and the Diversity in Corporate Leadership Act of 2020,[238] but neither act passed both houses. Diversity requirements have fared

233 Larcker & Tayan, *supra* note 15, at 1.

234 Hanna Ziady, *Germany Will Require Companies to Put Women Executives on Their Boards*, CNN, https://www.cnn.com/2020/11/23/business/germany-quotas-women-boards/index.html (Nov. 24, 2020, 5:09 AM).

235 Allison Herren Lee, U.S. Sec. & Exch. Comm'r, Diversity Matters, Disclosure Works, and the SEC Can Do More: Remarks at the Council of Institutional Investors Fall 2020 Conference (Sept. 22, 2020), https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

236 *See supra* note 6 and accompanying text.

237 *See* Improving Corporate Governance Through Diversity Act of 2019, H.R. 5084, 116th Cong. (2019) (amending section 13 of the Securities and Exchange Act of 1934 to require proxy statements to include the demographics of the board and any policies or strategy to improve the demographics of the board).

238 *See* Diversity in Corporate Leadership Act of 2020, S. 3367, 116th Cong. (2020) (requiring the Securities and Exchange Commission to create a Diversity Advisory Group which would study and make recommendations to improve board diversity).

better in state legislatures. California passed S.B. 826[239] in 2018 and A.B. 979[240] in 2020. These laws require public companies with headquarters in California to hire a specified number of female directors and directors from an underrepresented community by certain milestones. While other states have begun to follow California,[241] it is worth noting that S.B. 826 has been challenged[242] with arguments based on the Equal Protection Clause.[243] Despite legal challenges, regulation and legislation are the best ways to create sweeping systemic change—at least numbers-wise. In the short run, they ensure that diversity in the boardroom comes to the forefront of governance conversations and guarantee that at least one diverse director is onboarded. Legislation and regulation also have an important symbolic function: They demonstrate that board diversity is of serious importance and indicate to corporations and investors alike that the benefits of board diversity are real. This endorsement may eliminate biases held by directors, stakeholders, or institutional investors[244] that impede capturing all the advantages of board diversity.

A viable middle-of-the-road solution between disclosure requirements and quotas to increase board diversity in the short run is mandating corporations to follow the Rooney Rule when selecting a new board member. First implemented in the National Football League, the Rooney Rule requires every team to interview at least one minority candidate for a head coach position.[245] Translated to the corporate world, a Rooney Rule would require every corporation to interview at least one diverse candidate for an open director seat. A mandated rule is necessary as all-white boards interview an average of

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[239] S.B. 826, 2017–18 Leg., Reg. Sess. (Cal. 2018).

[240] A.B. 979, 2019–20 Leg., Reg. Sess. (Cal. 2020).

[241] Colorado, Pennsylvania, and Washington have passed bills, while Hawaii, Massachusetts, Michigan, Ohio, and New Jersey have introduced legislation. Jaclyn Jaeger, *Emerging State Board Diversity Laws Encourage Proactive Approach*, COMPLIANCE WEEK (Nov. 3, 2020, 11:40 AM), https://www.complianceweek.com/boards-and-shareholders/emerging-state-board-diversity-laws-encourage-proactive-approach/29681.article.

[242] *See* David A. Bell, Dawn Belt & Jennifer J. Hitchcock, *New Law Requires Diversity on Boards of California-Based Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 10, 2020), https://corpgov.law.harvard.edu/2020/10/10/new-law-requires-diversity-on-boards-of-california-based-companies (mentioning two California cases filed in opposition to S.B. 826). Bell, Belt, and Hitchcock suggest that another challenge to California's laws may be based upon the "internal affairs doctrine" in the Commerce and Full Faith and Credit Clauses, which suggests that the governing law for a corporation should be the law of the state where it is incorporated, not that of the state where it is headquartered. *Id.*

[243] The merits of these legal challenges are beyond the scope of this Note. As long as S.B. 826 and A.B. 979 stand as good law, similar types of legislation remain viable solutions.

[244] *See supra* note 178 and accompanying text.

[245] Choudhury, *supra* note 121, at 241–42 (advocating for the Rooney Rule as well).

0.2 racial or ethnic minority candidates out of 2.9 total candidates for an open seat.[246] Current directors deeply disagree on what inhibits board diversity, but it is telling that a large percentage of male directors believe that a lack of qualified candidates is the biggest obstacle.[247] This belief prevails over other views, including current directors not wanting to retire, the board not being interested in diversity, and the board not needing to be changed.[248] A Rooney Rule would show these directors that there are a plethora of qualified candidates. Similarly, male directors find racial and ethnic diversity to be the second least important factor in board composition; only age diversity is less important.[249] Perhaps even more jarring, more than half of male directors see board diversity efforts as manifestations of political correctness.[250] With such beliefs, boards need the push that a Rooney Rule provides in order to take board diversity seriously. A Rooney Rule would not surprise directors; such a policy is already on directors' radars and fifty-three percent of directors are strongly in favor.[251] It is already employed by the Midwest Investor Diversity Initiative, a major coalition of companies that manage over $750 billion.[252] The support of the Rooney Rule is perhaps indicative that companies and their directors are willing to vocalize support for diversity measures because "it's the right thing to do," but are only willing to go as far as providing people with access to the entrance without giving everyone a key. Thus, skeptical directors are likely to support this measure in comparison to a quota, as diverse candidates "do not gain any advantages when it comes to the ultimate selection of the board member."[253] Following the Rooney Rule also negates suggestions of tokenism, as appointed diverse directors are selected from a competitive field and hired due to their skills, expertise, and characteristics, instead of just *diversity*. However, it is important to note that the Rooney Rule has been criticized for failing to effectuate legitimate

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[246] Cheng et al., *supra* note 38 (finding that forty-seven percent of male candidates believe that qualified candidates are not available). See *supra* notes 223–24 and accompanying text for the comparable statistics for diverse boards.

[247] PwC, *supra* note 34, at 24.

[248] *Id.*

[249] *Id.*

[250] PwC, *supra* note 210, at 32.

[251] PwC, *supra* note 34, at 27.

[252] Derek T. Dingle, *Power in the Boardroom: Blacks in Corporate Governance*, BLACK ENTER. (Oct. 9, 2019), https://www.blackenterprise.com/power-in-the-boardroom-corporate-governance.

[253] Choudhury, *supra* note 121, at 241.

change,[254] as it does not negate pipeline problems, nor does it solve biases in hiring. Thus, it is important to consider long-term solutions which can tackle these issues and act as a secondary source to enhance board diversity.

2. *In the Long Run*

Ensuring that every corporate board has at least one diverse director will unmistakably be a monumental step in the right direction. However, the work cannot stop there. It is imperative that in the long run, legislatures, regulators, and companies strive to increase the number of diverse directors to a "critical mass." The benefits of board diversity may remain uncaptured benefits when a sole diverse director is tokenized and persuaded to go with the status quo. When boards are able to form a "critical mass" of diverse directors, the gains of board diversity become that much more realized. One study looking only at gender diversity finds that with only one woman on a board, the female director has a "possible impact but real risks of tokenism," with two women the "situation often improves but tokenism can still exist," and with three women a "critical mass" is finally reached.[255] When only a single woman is on the board, her identity as a woman is often considered prior to her identity as a fellow director. And indeed, she is found to be most utilized in "stereotypically female issues, such as work-life flexibility or the status of women in the organization."[256] It is not surprising that sole diverse directors may feel neglected, ignored, or invisible. While the isolation and exclusion aspects disappear when a second female director appears, a so-called "conspiracy phase" arises where male directors believe the two female directors collude with each other.[257] Additionally, female directors are considered interchangeable by their colleagues, which can reinforce the "tokenization" and stereotyping that diverse directors face.[258] A "critical mass" of three women finally enables "women directors [to] contribute normally, without having to face the effects of tokenism."[259] At this number, women are seen as independent and are valued for

[254] See generally Benjamin L. Solow, John L. Solow & Todd B. Walker, *Moving On Up: The Rooney Rule and Minority Hiring in the NFL*, 18 LABOUR ECON. 332 (2011) for an empirical study that criticizes the Rooney Rule and finds little support of its efficacy.

[255] Alison M. Konrad, Vicki Kramer & Sumru Erkut, *Critical Mass: The Impact of Three or More Women on Corporate Boards*, 37 ORGANIZATIONAL DYNAMICS 145, 147 (2008).

[256] *Id.* at 150.

[257] *Id.* at 153.

[258] *Id.*

[259] Akshaya Kamalnath, *Gender Diversity as the Antidote to 'Groupthink' on Corporate Boards*, 22 DEAKIN L. REV. 85, 105 (2017) (referencing the study conducted by Konrad et al., *supra* note 255).

their contributions as directors, rather than as females. The same phases of "tokenization," "conspiracy," and "critical mass" likely translate to the stages experienced by other types of diverse directors. In practice, a "critical mass"—even in the early stages—shows positive benefits. Firms with two or more female directors or minority directors have also demonstrated a higher correlation to firm value, at a statistically significant level, than their counterpart firms.[260] Firms with three or more female directors were found to monitor implementation of corporate strategy, communicate more effectively with other directors and shareholders, and promote stakeholder metrics like "customer satisfaction, employee satisfaction, . . . gender representation, . . . innovation and corporate social responsibility" better than other boards.[261] And while a "critical mass" has been found to be achieved when three board members of the *same* identity group are selected, due to the pervasiveness of white men on boards, it is likely to still be achieved when three *diverse* members are appointed, as their "otherness" may be a greater source of similarity than difference. The good news for companies is that once one diverse director is already on their boards, the chances of hiring another diverse director increase.[262]

This Note also recommends that boardrooms place diverse directors on executive and nominating committees. Research has consistently found that women tend to be underrepresented on boards in positions that can make a greater impact on the corporation. In particular, far fewer women are placed on executive and nominating committees.[263] These committees have enormous decisionmaking power on the corporation's conduct, in terms of both increasing shareholder value and considering other stakeholders and environmental, social, and governance factors. Executive committees often have their power described as "expansive" since most are chaired by the CEO and have the "power to direct and transact all business of the Corporation

[260] *See supra* notes 106–07 and accompanying text.

[261] Terjesen et al., *supra* note 58, at 329; *see also* Kamalnath, *supra* note 259, at 105 (citing a study that found women directors were only able to effectively influence organizational innovation on boards with three or more women).

[262] *See supra* notes 223–24 and accompanying text.

[263] Idalene F. Kesner, *Directors' Characteristics and Committee Membership: An Investigation of Type, Occupation, Tenure, and Gender*, 31 Acad. Mgmt. J. 66, 73 (1988); *see also* Dalton & Dalton, *supra* note 31, at 260 (noting that women comprised only 3.5% of *Fortune* 500 executive committees in 2001 and 9.8% by 2009); Molly Brennan, *A Strategic Approach to Board Composition and Diversity*, Corp. Bd. Member, https://boardmember.com/a-strategic-approach-to-board-composition-and-diversity (last visited July 30, 2021) (finding that "only 10% of lead independent directors and 4% of board chairs are women").

which properly comes before the Board of Directors."[264] Ensuring that diverse directors are on these exclusive executive committees is perhaps one of the most important ways to ensure that their directorship is not just symbolic nor one of tokenization. It is also crucial that diverse directors play major roles in decisionmaking so that the benefits of their representation actually come to fruition. Likewise, diverse nominating committees are essential because, as the name suggests, these directors put forth the names for new board members and other high-level executives. It is essential that more networks are represented on nominating committees, given that when directors were asked how they were initially introduced to the board they currently sit on, over half of Black directors and over one-third of white directors said it was through another director on the board.[265] In fact, for both Black and white directors, networking through the current board was more likely to lead to their directorship than being recruited by a search firm, knowing the CEO, knowing an executive, being appointed by a major shareholder, and being a current or former executive.[266] Placing diverse directors on the nominating committee can address criticisms of the Rooney Rule, as more diversity at the top leads to trickle-down effects of employee retention,[267] thus addressing a pipeline problem and negating potential hiring biases against new diverse directors. In order for there to be more parity in boardrooms, and for companies to truly receive both the short-term and long-term benefits of a diverse board, companies and policies imposing diversity requirements should address diversity in a more targeted manner, with a particular emphasis on executive and nominating committees.

Conclusion

Increasing board diversity is essential. Not only does it serve as an important signaling function that the voices of women and people of color are important in the corporate world, but it also provides a plethora of benefits to a corporation. Despite the fact that increasing board diversity is purely the equitable and fair thing to do, expansions of diversity in boardrooms have remained slow-moving. It appears that in order for board diversity to be taken seriously and actually accomplished, it must reach the forefront of corporate governance discussions and become integrated with other larger ongoing debates. This Note has shown that diverse boards improve firms' financial per-

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[264] Dalton & Dalton, *supra* note 31, at 260 (quoting Bank of America's charter).
[265] Cheng et al., *supra* note 38.
[266] *Id.*
[267] *See supra* notes 227–29 and accompanying text.

formance, business practices, and social sustainability. But to truly provide undeniable evidence that board diversity is beneficial, this Note views the benefits of board diversity through both a shareholder primacy lens and a stakeholder approach lens. Once corporations, directors, legislators, and other decisionmakers take notice that board diversity helps a corporation fulfill its purpose to both shareholders and stakeholders, expanding the diversity of boardrooms can become a priority. And until parity in a boardroom is achieved, every corporation is losing out on the numerous advantageous and value-creating short-term and long-term consequences of board diversity. Simply put, in order to further a corporation's purpose in today's world, it is necessary to create diverse boardrooms.

Appendix. Empirical Study Data Sets and Methodology

This Appendix summarizes the data sets and methodology used in the empirical studies in Section II.B, noting the definition of diversity used and the firm size, type of companies, and country of incorporation, when available.

Table 1. Definitions of Diversity in Empirical Studies

Number of minorities on the board	Number of the specified race of directors (discrete variable)
Number of women on the board	Number of women directors (discrete variable)
Percent of minorities on the board	Ratio of the specified race of director to total directors (discrete variable)
Percent of women on the board	Ratio of women directors to total directors (discrete variable)
Normalized Herfindahl-Hirschman Index	Calculating a score of 0 for a board where everyone has the same race or gender, and increasing the score as ethnic or cultural diversity increases (discrete variable)
Presence of women on the board	Comparing companies that have no women on the board with companies that have one or more women on the board (binary variable)

TABLE 2. SUMMARY OF EMPIRICAL STUDY DATA SETS

Study	Diversity Definition	Company Cohort
Adams & Ferreira (2002)	% of women on the board	1,066 publicly traded companies
Ahern & Dittmar (2012)	Presence of women on the board; % of women on the board	248 Norwegian publicly listed firms
Bonn (2004)	% of women on the board	84 Australian manufacturing firms
Campbell & Mínguez-Vera (2008)	Presence of women on the board; % of women on the board	68 Spanish non-financial firms
Carter, D'Souza, Simkins & Simpson (2010)	# of women on the board; # of minorities (Black, Hispanic) on the board	S&P 500
Carter, Simkins & Simpson (2003)	% of women on the board; % of minorities (African Americans, Asians, Hispanics) on the board	*Fortune* 1000
Catalyst (2007)	# of women on the board	*Fortune* 500
Catalyst (2011)	# of women on the board	*Fortune* 500
Credit Suisse (2012)	Presence of women on the board	All companies with market capitalization <$10 and >$10 billion
Erhardt, Werbel & Shrader (2003)	% of women and minorities (African, Hispanic, Asian, Native Americans) on the board	112 large public companies
Farag & Mallin (2016)	% of women on the board	892 Chinese Initial Public Offerings
Hunt, Layton & Prince, McKinsey (2015)	% of women on the board; Normalized Herfindahl-Hirschman Index	366 public companies in the UK, Canada, U.S., and Latin America
Hunt, Prince, Dixon-Fyle & Dolan, McKinsey (2020)	% of women on the board; Normalized Herfindahl-Hirschman Index	1,039 companies in 15 countries
Hunt, Prince, Dixon-Fyle & Yee, McKinsey (2018)	% of women on the board; Normalized Herfindahl-Hirschman Index	1,007 companies in 12 countries
Lagerberg, Grant Thornton (2015)	Presence of women on the board	S&P 500, FTSE 350, Indian CNX 200
Schrader, Blackburn & Iles (1997)	% of women on the board	200 U.S. firms with largest market value