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RECENT RESEARCH

The Advantages of a Diverse Board

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Bottom Line*: When it comes to corporate multiculturalism, it's the relationship between an ethnically diverse board and its CEO that makes the biggest difference for leading firms.*

There's little question that the executive suites and boardrooms of America's top companies have diversified over the past two decades. Plenty of research shows the increasing differences in gender, ethnicity, social class, and cultural background of directors and corporate officers at large firms. Proponents of diversity in business argue that minority leaders can provide unique insights and broaden their firms' knowledge networks, bringing their varied perspectives to bear on the complex decision-making process that occurs at the board level.

However, most of these studies have focused on how diversity at the apex of a company can show up in relatively broad measures of corporate performance, such as stock returns in the wake of a minority executive's appointment or the perceived ability to employ a more multicultural workforce. As a result of this wide-angle view, the findings have been fairly ambiguous and inconsistent.

In an attempt to provide a more comprehensive appraisal, a new study from Utah

State University's Alison Cook and Christy Glass examines the impact of leaders' diversity on firms' policies, organizational structure, and strategy. Specifically, Cook and Glass explore how a varied ethnic and racial makeup among CEOs and directors affects leading firms' governance styles — their administrative practices, human resource management, and long-term planning — as well as their ability to successfully innovate and upgrade existing product lines. These concrete, wide-ranging measures should provide a more pragmatic view of how diversity affects a firm's operations, the authors say.

Accordingly, they compiled a list of firms that made the Fortune 500 over a recent 10-year span and, using media reports and corporate websites, gathered demographic information on each company's CEO and board of directors. They also collected information on firms' financial performance, governance structure, product success, and R&D spending during that time.

Despite the recent rise in the number of minority leaders, such leaders still accounted for a relatively low percentage of executives and board members in the upper echelons of top corporations. As a result, the authors focused on one particular demographic: racially diverse CEOs and directors. If a member of an ethnic minority was both a CEO and a board member, the authors counted him or her only as an executive, so as to avoid overinflating the effects of particular individuals and to ensure a more conservative, realistic gauge of their influence.

Still, the results were powerful, and somewhat unexpected. The researchers found no evidence that minority CEOs, on their own, wielded enough sway to affect either corporate governance or product development, a point that goes some way to dispel the notion that simply hiring one person of minority background for a position of power automatically leads to changes in the way a firm functions.

Instead, companies with a higher level of racial diversity in the boardroom — in terms of the number of minority directors and their degree of experience and influence over corporate initiatives — typically implemented stronger governance mechanisms and pursued more breakthrough product improvements, the authors found. Indeed, Fortune 500 firms with a traditional CEO but a diverse board were the most successful at innovating and establishing effective operational systems, which underlines the need to spread multiculturalism throughout the corporate hierarchy.

Firms with a traditional CEO but a diverse board were the most successful at innovating.

"While promoting individual minority leaders is important," the authors write, "board diversity is paramount for achieving diversity-related benefits."

And when ethnically diverse directors were able to call on an extensive network of business contacts (as a result of their board memberships at other companies or their past experiences in the industry), firms with traditional CEOs saw an even more pronounced uptick in the efficiency of their innovation and operations.

Moreover, the authors saw no hint that firms with traditional CEOs and diverse boards suffered more conflicts, clashes in outlook, or communication breakdowns than their peer firms — a common concern of those who question the importance of diversity in the corporate hierarchy. And the impetus for change appears to flow more from boards to CEOs than the other way around, suggesting that "influential minority directors may be more likely to advocate for and appoint CEOs who…share their desire for strong governance, regardless of the CEOs' race or ethnicity," the authors write.

In the future, researchers should delve deeper, the authors suggest, and consider how the ethnic diversity of the rest of the top management team — including chief financial officers and key vice presidents — affects corporate outcomes. These top executives help the board and CEO craft policies and strategy, and they could have an even more direct impact on the organizational practices that stem from populating the executive suite with a varied demographic blend.

Source: "Do Minority Leaders Affect Corporate Practice? Analyzing the Effect of

Leadership Composition on Governance and Product Development," by Alison Cook and Christy Glass (both of Utah State University), *Strategic Organization*, May 2015, vol. 13, no. 2

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