

Equality and Human Rights Commission

An inquiry into

fairness,

transparency

and diversity in

FTSE 350 board

appointments

Executive summary

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Background

In July 2014 the Equality and Human Rights Commission ('the Commission') launched an inquiry into how the UK's 350 leading companies (the FTSE 350), and the executive search firms they instruct, recruit and select people for board director roles. Our aim was to identify whether recruitment and selection practices are transparent, fair and result in appointments on merit, and to identify areas where companies and their agents could make improvements to these practices to increase the diversity of company boards.

We wanted to examine how companies used the legal and regulatory framework set out in the Equality Act 2010 and UK Corporate Governance Code, to facilitate fairness, transparency and diversity in their board appointments.

The Equality Act 2010 requires that employers do not discriminate in recruitment processes. It also allows them to take 'positive action' where there is reason to think that a particular group is under-represented. The UK Corporate Governance Code states that there should be a formal, rigorous and transparent procedure for the appointment of new directors to the board and that appointments should be made on merit, against objective criteria and with due regard for the benefits of diversity on the board (FRC, 2014, p.11, B.2).

Our approach

Based on this framework, our inquiry examined the use of:

- board evaluations to identify required skills, experience and knowledge, and to assess the gender balance
- diversity policies that include aspirational targets for increasing the number of women at board and senior management level
- role descriptions that identify required skills, experience, knowledge and personal qualities
- search processes using a wide range of channels, including advertising, to encourage applications from diverse candidates with relevant skills, experience, and knowledge

- selection, interview and decision-making processes that allow for objective assessment of candidates' skills, experience, knowledge and personal qualities
- nomination committees in leading appointments and their awareness of equality law, and
- activities to improve diversity in the talent pipeline and to widen the pool of candidates for board roles.

Our methodology

We asked all the FTSE 350 companies and executive search firms that were signatories to the Voluntary Code of Conduct for Executive Search Firms (which set out best practice in gender diversity and search) to provide information about board appointments made in the 12 months preceding the launch of our inquiry in July 2014. We received responses from 92% of FTSE companies and 28 executive search firms that had carried out board appointments in our time period.

We also interviewed company and executive search firm representatives, and both successful and unsuccessful applicants for board roles.

This data has provided a strong basis for making the findings and recommendations in our inquiry report, which are summarised below.

Our findings

Boards' performance on gender diversity

We examined how boards are performing on gender diversity in light of the October 2015 announcement by Lord Davies that the FTSE 100 as a group had met a target of 25% female board members, the FTSE 250 was close to 20% and the FTSE 350 average as a whole was 21.9%.

We found that this headline figure concealed wide variations in the performance of individual companies. Most companies still fell below the 25% level. Fifty-five FTSE 100 companies had reached or exceeded the 25% target, but 45 had not. Two-thirds (168) of FTSE 250 companies had also not met this target.

While 47% of FTSE 350 companies increased their female board representation over the period of our review, in 46% of companies the proportion of women on their boards either remained the same or even decreased.

Where improvements had been made, this was as much due to a trend to reducing board size as it was to appointments of women. Of 150 companies that increased the proportion of women on their boards, 31% (46) had done so just by reducing their overall board size - they had reduced the number of men on the board but made no female appointments. Just 38% of these companies (58) met the target purely by appointing women and not reducing the size of the board.

The lack of women in executive director roles is particularly stark: nearly three-quarters of FTSE 100 companies and 90% of FTSE 250 companies had no female executive director in 2013/14.

Board evaluations

Board evaluations are an important method of assessing skills, experience and knowledge on the board, and reviewing diversity. Our inquiry reveals while over half of companies had carried out board evaluations which took into account gender diversity, over a third had not.

Diversity policies and targets

Where women or other groups are under-represented at board level, companies can develop a policy with aspirational targets to improve the diversity of the board over a specified timescale and establish measures to assess progress.

Our inquiry found that three-quarters of companies had board diversity policies. However, around two-thirds of these had not set objectives or targets to increase the number of women on their board. For senior management/executive levels, less than half of companies had a diversity policy and less than two-fifths had set gender targets.

Companies with a higher proportion of women on their boards were more likely to have a diversity policy that included objectives or targets for their senior management team. Companies that did not have objectives or targets for their board or senior management level were most likely to say that these were incompatible with appointment on merit or they did not believe that setting objectives or targets could help drive improvement.

Role descriptions

Role descriptions which are based on relevant skills, experience, knowledge and personal qualities that are objective, necessary and justifiable enable applications from a wider range of candidates and ensure fair and consistent assessment during the selection process. This can help increase diversity of appointments. We examined documentation from 25 companies that included role descriptions. We found that some companies

met these requirements. However, some companies had set requirements—such as a preference for candidates of a particular sex or age— that would almost always be unlawfully discriminatory.

Some required previous FTSE board experience. Making FTSE board experience a requirement, rather than specifying skills, experience and knowledge of issues such as corporate governance, shareholder relationships or global operations, risks ruling out suitable candidates from other sectors and could discriminate against candidates from groups that are under-represented on company boards.

Some role profiles required ‘chemistry’ or ‘fit’ with other board members but left these qualities undefined and so open to subjective judgement. This could lead to boards recruiting members in their own image. However, some companies translated ‘chemistry’ and ‘fit’ into skills or personal qualities they could assess in the selection process such the ability to work together, use judgement and contribute to constructive debate which would be beneficial to board efficiency.

Search process

Our evidence found that 90% of companies used executive search firms to source candidates. Boards that used executive search firms had a higher percentage of female non-executive and executive directors than those that did not. Many executive search firms were working to widen their databases to include more diverse candidates.

However, some companies had instructed their executive search firm specifically to find women, or set quotas for the number of women on a long or shortlist. These practices are likely to be unlawful under the Equality Act 2010 where they result in treating better qualified male candidates less favourably in the appointment process.

Publicising roles widely using different channels can encourage applications from diverse candidates with relevant expertise. Some company chairs recognised that advertising could open up board opportunities to a wider pool of diverse candidates. However, most FTSE companies rely on search and/or personal networks and do not advertise roles, meaning a wide range of diverse applicants with relevant experience have no opportunity to apply for most FTSE board roles.

Almost a third of companies using personal networks did not use any other means of publicising a post. We found virtually no advertising of board roles and little appetite for its use among executive search firms, who said it would be an inefficient method of selection and that advertising a sensitive role may impact on share price.

Selection

Using selection processes that allow for objective assessment of candidates' skills, experience, knowledge and personal qualities ensures that the best candidates are appointed on merit.

Our evidence shows that many companies select candidates for long and shortlists based on criteria set out in role descriptions. Most companies also rely on different types of interviews using questions based on the role descriptions and the unique experience of candidates.

However, some companies did not have a transparent and objective selection process for non-executive appointments, relying on personal recommendation without competition, or informal interviewing unrelated to criteria in the role profile. Informal interviewing could result in inconsistent assessment and allow room for 'unconscious bias' to affect judgements. Female candidates were sometimes asked questions about balancing work and family responsibilities, implying stereotypical assumptions about their capabilities, which could lead to legal challenge from candidates.

Most companies assessed 'chemistry' and 'fit' of candidates throughout the appointment process and, as these terms were vague and undefined, this could lead to inconsistent assessments and recruitment of board members in their own image.

The nomination committee

The UK Corporate Governance Code recommends that the nomination committee take responsibility for board appointments. Our evidence shows that in around a quarter of non-executive director appointments the board chair and/or nomination committee chair and nomination committee members were involved in all stages of the selection process. Just 4% of companies relied solely on the company and/or nomination committee chair.

Some respondents thought it was appropriate that board chairs played a significant role in appointments. Others believed that too much power lay in the hands of the company chair when he or she also chaired the nomination committee, and that separating the roles of the chair and nomination committee might encourage more debate about role requirements and the merits of selecting particular candidates.

Companies with a higher proportion of women on their boards had more women on their selection panels, ensuring that diverse perspectives inform appointments.

Half of companies with no women on their board said that they did not use a specialist advisor or provide any training about discrimination to those involved in board appointments. Just 13% of companies provided training on equality law and avoiding unconscious bias to those involved in the appointment process.

Improving diversity in the talent pipeline and candidate pool

Companies and executive search firms said the limited pool of suitably qualified female candidates was their greatest challenge to improving the proportion of women on boards.

Our inquiry found little knowledge of the range of positive action companies could take to encourage women to apply for roles or to help them gain skills to enable them to compete on merit on an equal footing with others. There was also little use of the ‘tie-break provision’, a specific form of positive action which can be used to appoint a candidate from an under-represented group where there are two or more candidates who are equally qualified.

For most companies, their only action to encourage applications from women was telling their executive search firm to include women on the candidate list. Around half indicated that they had targeted specific women, asked for all-female lists, or for women to be included on the long or shortlists, which risks unlawfully discriminating against any better qualified male candidates.

Some companies encouraged diverse applications by ensuring they had the right internal processes, such as having a policy or guidelines, setting targets, conducting their own searches or benchmarking their performance against other companies.

Companies with 25% or more women on their boards were more likely to have appointed executive or non-executive directors from outside the FTSE 350 than companies with no women on their boards, suggesting that companies seeking suitably qualified candidates from a wider pool are able to increase the likelihood of appointing a woman to their board. Most companies and executive search firms said candidates from outside the FTSE 350 were unlikely to have the appropriate skills, experience, knowledge or ‘fit’, such as financial skills, experience of corporate governance and shareholder relationships, or knowledge of an industry. However, companies that had recruited from outside the FTSE 350 reported benefits in terms of additional skills and perspectives these appointments brought to the board.

To encourage the development of women throughout the company, and particularly at senior levels, some companies used positive action such as training, development and leadership programmes, and provision of mentoring and networking opportunities for women. They also had good management practices that helped them retain female staff, such as offering flexible working and support when women returned from pregnancy. However, many companies were resistant to using positive action measures because of concerns about fairness and merit.

Recommendations

Board evaluations

- Use a board evaluation to assess the balance of skills, experience and knowledge on the board and to obtain information about its diversity composition.

Diversity policies and targets

- Use information about under-representation to create a diversity policy for the board and senior management which includes aspirational targets unique to the company.
- Make sure targets reflect realistic expectations of what can be achieved and do not result in pressure to take potentially unlawful steps.
- Report annually on progress in meeting these targets.

Role descriptions

- Ensure role descriptions describe necessary skills, experience, knowledge and personal qualities for the role, identified by the board evaluation.
- Avoid potentially discriminatory requirements, such as a preference for candidates of a particular age or sex, previous FTSE board experience where not justifiable, or using terms such as 'chemistry' or 'fit' which are subjective and undefined.

Search process

- Select an executive search firm that can demonstrate its effectiveness in improving diversity in appointments.
- Avoid giving unlawful instructions to an executive search firm, such as requesting an all-woman longlist or shortlist.
- Broaden your candidate pool by advertising appointments widely through appropriate channels, unless a role is business-sensitive.
- Avoid relying only on personal networks to identify potential candidates.

Selection

- Assess candidates consistently against objective criteria identified in the role description throughout the appointment process.
- Avoid questions about irrelevant factors that may introduce bias into the assessment process.
- Ensure selectors discuss their individual assessments where selection is based on one-to-one or informal interviews, to ensure consistency and reduce the impact of bias based on irrelevant factors or stereotypes.
- Define the skills, knowledge, experience and personal qualities that give rise to 'chemistry' and 'fit' and assess candidates against these criteria.

The nomination committee

- Ensure the nomination committee is involved in the appointments process alongside the chair.
- Ensure that the nomination committee and selection panels are diverse to bring different perspectives to the selection process.
- Provide training to everyone involved in the appointments process on equality law and avoiding unconscious bias.

In addition, the FRC should clarify the role and remit of the nomination committee and its chair in relation to diversity and board appointments and its disclosure requirements in the annual report.

Improving diversity in the talent pipeline and candidate pool

- Encourage executive search firms to identify ways of attracting more applications from women, and question the firms about their efforts if the candidate list is not diverse.
- Widen the candidate pool for board roles by considering suitably qualified individuals from outside the FTSE 350, such as the professions, the not-for-profit and public sectors, and academia.
- Use positive action measures to encourage individuals from under-represented groups to apply for roles or to help them gain skills which will enable them to compete on merit on an equal footing with others, such as training, development and leadership programmes, mentoring and networking opportunities.
- Use the tie-break provision to select a candidate from an under-represented group where there are two or more candidates who are equally qualified.
- Adopt management practices that support women's retention, such as improved management of women who are pregnant or return from maternity leave, flexible working and flexible career paths.

We expand on these recommendations in this report and in our guidance 'How to improve board diversity: a six-step guide to good practice'.

Contacts

This publication and related equality and human rights resources are available from the Commission's website: www.equalityhumanrights.com

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