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Why Quotas Are Unlikely To Be The Most Effective Way Of Diversifying The Boardroom

By Randall S. Peterson, Professor of Organizational Behaviour, London Business School

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Nasdaq's diversity efforts are again attracting attention almost six months after the US Securities Exchange Commission (SEC) endorsed a proposal requiring the boards of Nasdaq-listed companies to reflect particular diversity requirements. The rules require these boards to have a minimum of one female director and one director from the LGBTQ+ community or an underrepresented minority. If they do not meet these requirements, they must explain why not.

Now, 17 US states are backing a lawsuit that challenges the SEC's endorsement.

Nasdaq describes its Board Diversity Rule as "a disclosure standard designed to encourage a minimum board diversity objective for companies and provide stakeholders with consistent, comparable disclosures concerning a company's current board composition."

That ambition is undisputedly worthy. The makeup of boards almost always fails to reflect the diversity of broader society, or even a company's own customer base. Notably, Nasdaq's own 2020 research found that over 75% of the companies listed with it did not meet it proposed new requirements at the time. And, while progress to increase the number of black, Asian or minority ethnic directors on FTSE 350 boards has been made (up 108% in just a year), 55% of these companies were still without any ethnic minority directors in December 2021.

There is a big difference between adding diverse voices to a group and actually engaging those voices.

For diversity to have any impact, you need the group to want to engage, adapt and change in response to the diverse perspectives. That is why strict quotas generally do not work. If groups are determined to not listen to perspectives and ideas from diverse voices, it is extremely difficult to force them to do so.

For boards, simply appointing one or two directors from underrepresented backgrounds to meet a legal quota provides no guarantee that these individuals' views and advice will be heard or actioned. Directors from underrepresented backgrounds who find themselves routinely ignored or isolated by their peers may come to perceive their inclusion on a board as little more than a 'box ticking' exercise and choose to take their expertise elsewhere or opt-out of such leadership opportunities entirely.

That is why targets, set to make diversity intentions clear and measurable, are generally more effective than mandatory quotas in setting the bar for what 'normal' should be. Most of the times clear numerical targets work because the members do not feel forced into accepting something they would not otherwise do.

Take, for instance, the significant efforts FTSE 350 companies have made to diversify their boards referenced earlier.

The Parker Review's 2017 report stated "each FTSE 100 Board should have at least one director of colour by 2021; and each FTSE 250 Board should have at least one director of colour by 2024."

Whether all FTSE 100 companies successfully met their 2021 target is still to be seen. However, the Parker Review's targets (rather than quotas) appear to have translated to tangible change: by March 2021, 81% of FTSE 100 companies had at least one director of colour. In January 2020, that number was just 52%.

Efforts to increase the number of women on FTSE 350 boards through the setting of nominal targets have been similarly successful.

Just occasionally, targets don't work and so quotas do become necessary. But do not be fooled by what groups look like under quotas. To achieve the intent behind the quota, the controlling majority need to see some reason for the quota and diversification to be open to the change that should come with greater diversity.

The hard work of helping people understand why change is necessary stands separate from representation in this case. Reaping the benefits of diversity requires more than quotas.

Randall S. Peterson is a Professor of Organizational Behaviour at London Business School and Academic Director of its Leadership Institute. His current research activities include investigating: how CEO personality affects top management team interaction, board dynamics, leading diverse teams, conflict management in teams, and the effects of member personality on group interaction and performance.