GULF NEWS
ANALYSIS
Published: August 4, 2019

Boards of Global Firms Lack International Diversity

Directors with vast emerging market expertise would boost competitiveness

By Harry G. Broadman, Special to Gulf News

An increasing number of boards of public companies in advanced countries have finally begun aggressively diversifying membership by gender, ethnicity, and age. That is all to the good. However, they are overlooking an additional critical goal for diversity: bringing on directors whose careers are marked by broad operational experience working on the ground in a variety of international geographies, most importantly across fast-growing emerging markets.

The interests of shareholders are best served by having boards well equipped to guide management teams through periods of dynamic changes in market growth and risks. With the dramatic rise of trade and investment flows between mature economies, such as the U.S., the EU and Japan, and emerging markets over the past few decades, to say that businesses in the advanced countries are operating in such a period is an understatement.

From my own experience on the boards where I sit, the importance of having a cadre of fresh directors who innately understand how to balance deftly emergent opportunities and challenges, whether commercial, economic policy-related, political, or technologically driven, cannot be overstated.

Over the last decade and a half, average annual GDP growth (adjusted for inflation) in emerging markets has been at least twice the rate as that of advanced countries. Significantly, that growth multiple has been steady across business cycles throughout this period and will continue to do so for the foreseeable future. This reflects a structural shift in the secular growth pattern of the global economy.

The result is that today, the economic output of emerging markets contributes to more than one-half of the world's GDP—a change from just a decade ago when advanced countries held that position. Even more important than the reversal of which markets produce the greatest share of global output is that the growth rate of the expansion of world GDP is now primarily propelled by emerging markets. In short, emerging markets are now the engines of global growth.

It is true that a number of boards—often with the help of the executive search firms with whom they work—have been bringing on individuals from the companies' home countries who have had stints abroad. Frequently it is the result of their service in government positions either in a civilian foreign or economic policy capacity or as former military officials. Frankly, such experience tends to have limited relevance to hardcore business operations.

At the same time, boards have given membership to citizens outside firms' home countries. Not only is the incidence of such diversification small, but the foreign nationalities typically sought are "close to home"—in terms of geography, economic status, legal institutions, and culture. In the case of U.S. firms, Spencer Stuart's 2018 survey indicates 8% of all directors on the boards of the top 200 S&P 500 companies were of non-U.S. origin. More robust data on companies across 39 countries over 2000-2013 collected by BoardEx reveal foreigners account 5% of all corporate directors.

But is it enough to have just directors of foreign nationalities—even if they are from emerging markets—on boards? Available data suggest bringing on foreigners to a board does raise the prospects for a successful acquisition or greenfield investment in the director's home country, but little else compared to what other board members contribute. In fact, there is evidence that cultural differences in dealing with business matters by foreign directors may actually act as a weight on the efficiency of board operations in terms of monitoring CEO performance and designing and executing incentive and discipline schemes of senior executives.

So how best to remedy the increasing disjuncture between the composition of boards and the internationally diverse operational, legal and cultural geographic footprints of the firms they govern as reflected in the foreign location of production facilities, sales of output, input purchases for supply chains, identities of competitors, and the profiles of customers, shareholders and workers?

Having board members who have worked overseas is certainly part of the answer. The Spencer Stuart data show that 32% of directors of the top 200 of the S&P 500 have "global professional experience, defined as having worked at an international location." Yet these data do not inform us as to what type of international markets in which these experiences occurred. Working in the U.K. or Germany will provide very different insights for effective board governance of a large multinational corporation than assignments in China or Brazil, for example.

What is really needed are directors who have cut their teeth in various operations across an array of emerging markets. Two examples illustrate why such attributes are so critical if mature country firms want to maintain, let alone enhance, their competitiveness in the face of rapid growth by rivals based in less advanced parts of the world.

Directors with significant business experience in emerging markets are well positioned to provide advice on how to compete in such environments. This is especially pertinent regarding best business practices that comply with corruption protocols, such as the U.S. Foreign Corrupt Practices Act (FCPA) or the UK Anti Bribery Act.

By the same token, most boards in advanced country firms have only a crude understanding of the national security regulatory processes governing—and more importantly the counter-strategies needed for responding to—inbound transactions by competing emerging market firms, such as from China. For U.S. companies, regrettably this is the case despite sizeable press coverage of the operations of the Committee on Foreign Investment in the US (CFIUS) and its new statutory authority under the Foreign Investment Review Modernization Act (FIRRMA). In the EU, the establishment of a similar entity is underway; there, boards will face challenges akin to their U.S. counterparts.

Boards of multinational corporations would do well to become multinational themselves.

Harry G. Broadman is a Partner, Managing Director and Chair of the Emerging Markets Practice at the Berkeley Research Group LLC, a global expert witness consultancy, where he focuses on international trade and investment disputes and arbitration; antitrust litigation; CFIUS-related matters; FCPA cases; and corporate governance. He is also on the faculty of Johns Hopkins University. He serves as an independent director on several corporate boards and is a Board Governance Fellow and Master Workshop Faculty Member at the National Association of Corporate Directors (NACD). He has worked at PwC; in the private equity industry; the RAND Corporation; and the World Bank. Earlier he was United States Assistant Trade Representative; Chief of Staff of the President's Council of Economic Advisers; and a faculty member at Harvard University.

Contact: http://www.harrygbroadman.com