

February 2022

## Strengthening Boards Through Diversity: A Two-Sided Market That Can Be Effectively Serviced By Intermediaries

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### Recommended Citation

Akshaya Kamalnath, *Strengthening Boards Through Diversity: A Two-Sided Market That Can Be Effectively Serviced By Intermediaries*, 40(1) LAW & INEQ. 155 (2022), DOI: <https://doi.org/10.24926/25730037.642>.

## Strengthening Boards Through Diversity: A Two-Sided Market That Can Be Effectively Serviced By Intermediaries

Akshaya Kamalnath<sup>†</sup>

### Abstract

*The current focus on the monitoring role of the corporate board has come under much criticism. Independent directors play a significant role within this model. However, their ability to truly function independently has been rightly questioned in the last decade. Independent directors are impeded by two main problems: first, the lack of access to relevant information, for which they are reliant on management, and second, the high likelihood of being captured (to varying degrees) by management. There have been various suggestions to fix these problems, ranging from enhancing board diversity to drastically reforming the current model of corporate boards.*

*This Article argues that diversity holds the promise of slowly reforming the current board model, so long as well-considered measures are taken. To that end, this Article will propose a model of board governance that relies on providers of supplemental board services as intermediaries to facilitate diversity on boards. This model will, on the one hand, allow companies to attract both the best and diverse directors and on the other hand, allow board candidates (especially diverse candidates) to make well-informed decisions about taking on directorships. Eventually, companies may choose to share these reports with investors and the general public to signal their commitment to diversity and governance. Finally, the proposed model has the potential to drive boards to take on more of an advisory role along with the current focus on monitoring.*

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## Introduction

The present model of the board of directors has come under much criticism, and the search is on for both potential fixes to the existing model and new governance models.<sup>1</sup> This Article argues that diversity can strengthen boards, provided that effective mechanisms are adopted as well. It will propose a model where supplemental providers of board services, like executive search firms and board evaluation providers, can assist in obtaining these benefits.

Increasing diversity on corporate boards has become an important issue for two reasons. First, diversity on corporate boards, by increasing workplace diversity (with a focus on demographic diversity), helps to reduce workplace inequality.<sup>2</sup> Second, diversifying the corporate board increases the variety of perspectives in decision making, which in turn improves corporate governance.<sup>3</sup>

Since gender diversity is easily measurable and most people agree on the need for gender equality, corporate diversity has come

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1. See, e.g., MELVIN A. EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* 141–56 (1976) (critiquing the modern board practice and offering proposals for reform of the existing working models and legal models); see also Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 *STAN. L. REV.* 1051, 1072 (2014) (arguing that companies should outsource board activities as an alternative to the current practices).

2. See Mark McCann & Sally Wheeler, *Gender Diversity in the FTSE 100: The Business Case Claim Explored*, 38 *J. L. & SOC'Y* 542, 574 (2011) (“Women should be appointed as NEDs as an issue of social justice . . .”).

3. See Akshaya Kamalnath, *Defining Diversity in Corporate Governance: A Global Survey*, 45 *J. LEGIS.* 1 (2018) (discussing the meaning of diversity within corporate governance).

to focus mostly on gender.<sup>4</sup> The re-emergence of the Black Lives Matter movement following the murder of George Floyd has also brought attention to racial diversity in corporate boards.<sup>5</sup> This Article will show how the benefits of equality and corporate governance due to diversity on corporate boards are intertwined.

Before elaborating on these combined benefits of board diversity, it is necessary to mention that there is also a “business case” for board diversity; proponents of this business case attempt to show that diverse boards can be linked to increased profitability.<sup>6</sup> However, this is a very difficult link to prove, since a firm’s profits are dependent on numerous factors. This problem is not unique to board diversity. The economic value of other corporate governance best practices, like independent directors, is also difficult to prove empirically, again because firm profits are dependent on various factors. Despite this difficulty, there is a continued reliance on the business case for board diversity, most likely because it is the easiest and most attractive way to “sell” board diversity to various groups.<sup>7</sup> This Article will not focus on the business case for diversity on boards nor the studies that have shown a correlation (positive or negative) between women directors and increased profits.<sup>8</sup>

Returning to the benefits of board diversity, the link between motivations for equality and motivations for corporate governance becomes clear when we think about what is meant by “corporate governance.” Although the board’s monitoring role is often the priority in large, public companies, corporate governance also

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4. *Id.* at 2.

5. See Gaurdie Banister, *How Black Lives Matter in Corporations—This Time Can Be Different*, CORPORATE BOARD MEMBER, <https://boardmember.com/how-black-lives-matter-in-corporations-this-time-can-be-different/> [https://perma.cc/JM94-94FQ].

6. See Lisa M. Fairfax, *The Bottom Line on Board Diversity: A Cost-Benefit Analysis of the Business Rationales for Diversity on Corporate Boards*, 2005 WIS. L. REV. 795, 810–30 (2005) (using a cost-benefit analysis to argue that some business case rationales are flawed); see also McCann & Wheeler, *supra* note 2, at 557–73 (showing that the business rationale did not hold up based on an empirical analysis of FTSE 100 companies).

7. See Darren Rosenblum, *When Does Sex Diversity on Boards Benefit Firms*, 20 U. PA. J. BUS. L. 429 (2018) (critiquing corporate reliance on business case arguments for increasing board diversity).

8. See, e.g., Akshaya Kamalnath, *Corporate Governance Case for Board Gender Diversity: Evidence from Delaware Cases*, 82 ALB. L. REV. 23, 28–29 (2018) (“The first wave of empirical literature on board gender diversity focused on the link between women directors and firm profits. However, the results of these studies are far from unequivocal, with some showing a positive correlation, others showing a negative correlation and still others showing no correlation.”) (footnotes omitted).

involves providing both strategic guidance to management and access to various resources and networks.<sup>9</sup> Drawing from these functions, the Organization for Economic Co-operation and Development defines corporate governance as follows:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.<sup>10</sup>

The emphasis on the board's monitoring role means that the benefits to corporate governance from diversity are understood as an improvement in the board's monitoring function.<sup>11</sup> Thus, the argument that diverse candidates, by bringing in different perspectives, do a better job of assisting the board in questioning and monitoring management has rightly gained ground.<sup>12</sup> However, the fact that boards also guide management, especially in times of crisis, means that boards should be attuned to the needs of various stakeholders.

Similarly, diverse candidates might also allow companies to access social networks that they might not otherwise be able to access.<sup>13</sup> The equality rationale mainly seeks to address the problem of qualified women and other minority groups being unable to access board positions as a result of conscious or unconscious bias.<sup>14</sup> However, this rationale could be expanded further to incorporate the idea that diverse boards would be better able to

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9. OECD, G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE 13, 45 (2015), [https://www.oecd-ilibrary.org/docserver/9789264236882-en.pdf?expires=1593925258&id=id&accname=guest&checksum=06E9199088BE18A42F2D9F92B476C436\\_\[https://perma.cc/9QXK-DJNP\]](https://www.oecd-ilibrary.org/docserver/9789264236882-en.pdf?expires=1593925258&id=id&accname=guest&checksum=06E9199088BE18A42F2D9F92B476C436_[https://perma.cc/9QXK-DJNP]).

10. *Id.* at 9.

11. See Kamalnath, *supra* note 8, at 23.

12. See Rene B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. FIN. ECON. 291 (2009) (finding that female directors enhance monitoring); see, e.g., Michal Barzuza, *Proxy Access for Board Diversity*, 99 B.U. L. REV. 1279, 1284 (2019) (arguing that diversity can increase board accountability because “[d]iversity is likely to increase board turnover, independence, and monitoring functions”).

13. See Debbie A. Thomas, *Bias in the Boardroom: Implicit Bias in the Selection and Treatment of Women Directors*, 102 MARQ. L. REV. 539, 559–60 (2018) (noting that board members have a tendency to recruit new members from a homogenous, small, and personal network instead of from a more diverse pool of individuals).

14. McCann & Wheeler, *supra* note 2, at 550 (“[I]n a world where rights to gender equality are seen as a basic human right there can be no case for exclusion.”); see also Thomas, *supra* note 13 (discussing the role of implicit bias in preventing women from obtaining board positions).

guide management with regard to problems concerning various stakeholder groups. Although not theorized in this manner, we see in practice that companies and the general public react to a crisis involving the mishandling of sexual harassment claims by adding a woman director,<sup>15</sup> or to racial injustice issues by calling for a Black director.<sup>16</sup> While some of these may be ill-advised knee-jerk reactions, which could impose heavy burdens on minority directors, these early stirrings indicate that the rationales for equality and corporate governance are connected.

Therefore, diversity can strengthen boards in many ways, as long as all stakeholders are aware of and guard against issues like tokenism, stereotyping, and overburdening diverse members on the board. This Article proposes a model that will address each of these issues. Part I will outline the issues with the current monitoring board model and examine some of the fixes and alternatives that have been proposed. Part II will discuss the diversification of boards, showcasing the promise this could have for companies but also exploring the potential issues that could impact companies and diverse candidates. Part III will then propose a model that relies on third-party intermediaries to service companies, diverse board members, and eventually other stakeholders. This Article will conclude with some thoughts about future research on this topic.

## I. The Current Monitoring Board – Problems and Solutions

The board of directors has three functions: to provide strategic advice,<sup>17</sup> bring valuable resources in the form of expertise and access to networks,<sup>18</sup> and monitor management.<sup>19</sup> Although the board of directors is generally required to run the company, it became apparent by the 1970s that, for large, public companies, the board of directors would not be involved in the day-to-day

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15. See, e.g., Michelle Meyers, *Arianna Huffington Becomes Uber's First Female Board Member*, CNET (Apr. 27, 2016), <https://www.cnet.com/news/arianna-huffington-becomes-ubers-first-female-board-member/> [https://perma.cc/Y9YH-DE9V] (“[Huffington’s] addition to Uber’s board comes as the company . . . faces an outcry over its record of passenger safety, particularly for women.”).

16. See Banister, *supra* note 5.

17. Jill E. Fisch, *Taking Boards Seriously*, 19 CARDOZO L. REV. 265, 267 (1997).

18. Lynne L. Dallas, *The Relational Board: Three Theories of Corporate Boards of Directors*, 22 J. CORP. L. 1, 10 (1996).

19. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 308 (1976) (noting that the monitoring model of the board is based on agency theory).

management.<sup>20</sup> As a result of this change, Professor Melvin Eisenberg proposed that boards take on a stronger monitoring role.<sup>21</sup> He proposed that the board's primary functions were to supervise, monitor, and select executive management.<sup>22</sup> In order for boards to perform these functions effectively, Eisenberg believed that laws should ensure that boards are independent of the executives they monitor and that they receive adequate and objective information, which would enable them to properly execute their monitoring function.<sup>23</sup>

Based on the recommendations of Eisenberg and a few others,<sup>24</sup> the American Law Institute (ALI) sought to enhance the monitoring, or oversight, function of the board in a draft of its 1984 Principles of Corporate Governance.<sup>25</sup> Ultimately, the Principles were published with a focus on increasing the number of independent directors on the board rather than making any substantive changes to the content of directors' duties.<sup>26</sup> Such a focus on independent directors has now been adopted in almost all of Delaware's jurisdictions.<sup>27</sup> This idea has been stamped into U.S. corporate law through the rules of the Securities and Exchange Commission (SEC) and the stock exchanges, NYSE and NASDAQ, which require public corporations to have a majority of independent directors on the board and on many board committees.<sup>28</sup>

The independent-director model has, however, come under increasing scrutiny, especially after the global financial crisis, in which large companies with a majority of independent directors failed to adequately monitor their management.<sup>29</sup> The main

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20. See George W. Dent Jr., *The Revolution in Corporate Governance, the Monitoring Board, and the Director's Duty of Care*, 61 B.U. L. REV. 623, 623, 625 (1981).

21. EISENBERG, *supra* note 1, at 162–68.

22. *Id.* at 162, 168.

23. *Id.* at 170.

24. Dalia Tsuk Mitchell, *The Import of History to Corporate Law*, 59 ST. LOUIS U. L. J. 683, 688–90 (2015).

25. PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3.04 (AM. L. INST. 1984) (tentative draft No. 2).

26. Mitchell, *supra* note 24, at 690.

27. *Id.* (“Fully embracing the model as a structural rather than substantive one, the Delaware courts focused on the role of the independent directors.”).

28. Robert Charles Clark, *Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policy Makers Too*, 22 GA. ST. U. L. REV. 251, 282–88 (2006).

29. See, e.g., Theodore N. Mirvis & William Savitt, *The Dangers of Independent Directors*, 40 DEL. J. CORP. L. 481 (2016); see also Claire A. Hill & Brett H. McDonnell, *Reconsidering Board Oversight Duties After the Financial Crisis*, 2013

criticism is that independent directors are unable to act *truly* independently of the CEO, and are therefore unable to effectively monitor management.<sup>30</sup> One explanation for this failure is that independent directors often belong to the same social circles as the CEO, making them sympathetic to the CEO and unlikely to challenge a course of action suggested by the CEO.<sup>31</sup>

Even if independent directors were able to truly be independent of management, independent directors usually lack firm-specific commitment to their companies.<sup>32</sup> Beyond the global financial crisis, scholars have analyzed isolated corporate scandals and concluded that independent directors are so over-committed that they are unable to adequately monitor management.<sup>33</sup> Independent directors are reliant on the CEO for information about the company, which makes it difficult for independent directors to effectively oversee management.<sup>34</sup> Even when they are provided with all of the relevant information, independent directors are often unable to digest vast amounts of information because they hold multiple board memberships and are often themselves executives and CEOs of other companies.<sup>35</sup>

Following the acknowledgement of these deficiencies in the monitoring model of the board, with independent directors as the sharpest tools in the box, it is natural that scholars and companies have been looking for alternatives. At one extreme is the proposal by Professors Bainbridge and Henderson, who propose that the job of boards may be altogether outsourced to external service providers, such as law firms and auditing firms.<sup>36</sup> However, this proposal has not had much practical uptake even outside the United

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U. ILL. L. REV. 859, 874–75 (2013) (arguing that financial catastrophes, such as those at the center of *In re Goldman Sachs* and *In re Citigroup*, show that companies need to better monitor information, control, and risk management systems to avoid liability).

30. See, e.g., Erica Beecher-Monas, *Marrying Diversity and Independence in the Boardroom: Just How Far Have You Come, Baby?*, 86 OR. L. REV. 373 (2007).

31. Fisch, *supra* note 17, at 270.

32. Mirvis & Savitt, *supra* note 29, at 487–88.

33. Jeremy C. Kress, *Board to Death: How Busy Directors Could Cause the Next Financial Crisis*, 59 B.C. L. REV. 877, 918 (2018).

34. E.g., DAVID F. LARCKER & BRIAN TAYAN, NETFLIX APPROACH TO GOVERNANCE: GENUINE TRANSPARENCY WITH THE BOARD 1 (2018) (discussing the “information gap” between management and boards that arises as a result of board members not being actively involved with daily operations).

35. Akshaya Kamalnath, *The Perennial Quest for Board Independence: Artificial Intelligence to the Rescue*, 83 ALB. L. REV. 43, 49 (2019).

36. Bainbridge & Henderson, *supra* note 1, at 1072.

States, particularly in countries where corporations are not prohibited from being board directors.<sup>37</sup>

An alternative model, which has come out of innovative practices at Netflix (the Netflix Model), proposes that directors have better access to information.<sup>38</sup> This model includes two practices not seen in the traditional board model. The first practice is that directors regularly attend monthly and quarterly senior management meetings, albeit in an observational capacity.<sup>39</sup> The second practice is that board communications are “structured as approximately 30-page online memos in narrative form that not only include links to supporting analysis but also allow open access to *all data and information* on the company’s internal shared systems, including the ability to ask clarifying questions of the subject authors.”<sup>40</sup> These communications are then “shared with the top 90 executives as well as the board.”<sup>41</sup> The CFO of Netflix explains the second practice as follows:

[The board memo] is part of the evolution from a presentation culture to a memo-based culture [internally across the company]. Once you have the ability to effectively write collaboratively, you can then graduate to a memo that is collaboratively written . . . The central coordinator, if there is one, is likely Reed [Hastings, the CEO of Netflix] himself or my Financial Planning & Analysis group. Or, for each of the areas that are writing these deeper memos, they have the C-level owner take responsibility for that.<sup>42</sup>

A third practice that some companies might claim to have, although uncommon, involves a board culture steeped in amenable collaboration. One board member describes this culture as follows:

Reed [Hastings] has always been masterful at hiring really good people, pushing decision making to those people, and not micromanaging. Letting decisions roll up and be debated rather than micromanaged. That style, that kind of management philosophy rolls up into the board meetings where any one of the members of [the CEO]’s staff can comment or disagree, or take questions from any of us around the table and answer them openly.<sup>43</sup>

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37. The lack of reporting on the outsourcing of board services indicates that it has likely not yet occurred; should a company outsource its board services, there would most likely be ample reporting of the matter.

38. LARCKER & TAYAN, *supra* note 34, at 1.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at 3 (first and second alterations in original).

43. *Id.* at 3–4.

Another board member says that “the overall tone Reed has set, really from early days, is around transparency . . . . There is no editorializing. There’s no censorship.”<sup>44</sup>

Although the directors talk about the quality of board members, the striking point about culture that comes from these comments (quoted above) is that both board members and the management staff are free to disagree, ask questions, and voice their own ideas.<sup>45</sup> This underlines the important role the CEO plays in setting the tone and culture, not only for the board of directors, but also for members of the management team.<sup>46</sup> This open culture is crucial for Netflix’s practices of facilitating information flow through board attendance at management meetings and the thirty page memos provided to the board pre-meeting. It is questionable whether the Netflix Model can be adopted in its entirety by larger companies with numerous management teams. Board members would be grossly over-extended if they were required to attend *all* management meetings for large companies. Some aspects of the Netflix Model, however, should be encouraged in larger companies, particularly the CEO facilitating a culture of openness and freethinking in the board and management teams.

Ronald J. Gilson and Jeffrey N. Gordon provide an additional alternative to the current monitoring board model: they call it the “Board 3.0” Model, and propose that board members are “*thickly informed, well-resourced and highly motivated,*” similar to the private equity model.<sup>47</sup> Calling the initial advisory model of the board, “Board 1.0,” and the next monitoring model of the board, “Board 2.0,” Gilson and Gordon explain that two developments since the adoption of the Eisenberg model required a change in board models: (1) the switch to majoritarian, institutional ownership of most large public companies, and (2) the rise of hedge funds.<sup>48</sup> These developments indicate that management is being challenged by activist investors, and Gilson and Gordon argue that the board should be able to either defend management against such attacks

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44. *Id.* at 4.

45. *Id.* at 3–4.

46. The idea of management setting the tone at the top is often used in the context of corporate culture. See, e.g., Alfredo Contreras, Aiyasha Dey & Claire Hill, *Tone at the Top and the Communication of Corporate Values: Lost in Translation*, 43 SEATTLE U. L. REV. 497 (2020).

47. Ronald J. Gilson & Jeffrey N. Gordon, *Boards 3.0: An Introduction*, 74 BUS. L. 351, 353 (2019).

48. *Id.* at 352–53.

or, where appropriate, insist that management take the challenges seriously.<sup>49</sup>

Like other critics of the current monitoring model, they also believe that Board 2.0 directors were not strong enough on oversight of the company's strategy and operational performance because of both time constraints and dependence on the CEO for information.<sup>50</sup> These issues led Board 2.0 directors to rely on stock prices to evaluate management.<sup>51</sup> To overcome these issues, Gilson and Gordon proposed the Board 3.0 Model, in which "directors could credibly *to themselves* and to majoritarian owners assert that the stock price is missing a critical element of expected future realizations."<sup>52</sup> They see the Board 3.0 Model as mirroring the private equity model, which charges the board with a mix of monitoring and operational roles.<sup>53</sup>

[A] Board 3.0 . . . is a board that contains a mix of directors on the current Board 2.0 model and "empowered" directors ("3.0 directors") who would specifically be charged with monitoring the strategy and operational performance of the management team. The 2.0 directors would serve, as now, on compliance-focused committees and otherwise take on the board's responsibilities, especially serving on "special committees" as necessary. The 3.0 directors would serve on an additional committee, the "Strategy Review Committee." Those directors would be supported by an internal "strategic analysis office" that would provide back-up support for a 3.0 director's engagement with the management team. If additional support was necessary, the 3.0 directors could engage outside consultants.<sup>54</sup>

Gilson and Gordon also address the issue of independent directors not being able to operate independently of management by proposing that Board 3.0 directors should have limited terms so that they are not "captured" by management.<sup>55</sup> While the compensation structure for independent directors is an important issue,<sup>56</sup> this Article will not focus on it because effective monetary incentives alone are not enough to address the main issues plaguing

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49. *Id.* at 353.

50. *Id.* at 356.

51. *Id.*

52. *Id.* at 357.

53. *Id.* at 359.

54. *Id.* at 361.

55. *Id.*

56. Gilson & Gordon, *supra* note 47, at 361 (proposing that the 3.0 directors within their new board model would be paid mainly through long-term stock compensation to incentivize them to enhance value creation for the company).

the current monitoring board model (i.e., directors being poorly informed).<sup>57</sup> Importantly, the Board 3.0 Model is currently hypothetical and is something that companies might experiment with in the future.<sup>58</sup> However, a voluntary pivot to this model is unlikely because companies would need to overcome status quo bias.<sup>59</sup> In any case, the take-home message of the Board 3.0 Model is that there are elements of the monitoring model that are worth retaining, but other elements relevant to the advisory model of the board are worth introducing.

The next proposal to fix the problems of the current monitoring model of the board comes from Faith Stevelman and Sarah Haan, who have suggested some “relatively low-cost, low-risk changes” that they believe would “improve boards’ ability to deliver on the promise of improved corporate governance.”<sup>60</sup> Their proposal consists of eight points: (1) separation of the CEO’s and the Chair’s roles; (2) being transparent about the CEO’s involvement in the director search process; (3) increasing board diversity; (4) a non-binding expectation that director terms would be limited to a certain number of years; (5) the professionalization of directors via credentialing as in the case of doctors and lawyers; (6) board self-evaluation with the board chair, using these surveys to gauge the directors’ understanding of the company’s interests and also in the director selection process; (7) the creation of an informational infrastructure (similar to the one adopted by the Netflix Model, but different than directors actually being present at management meetings) that lets information flow directly to the board, rather than through the CEO;<sup>61</sup> and (8) designing internal codes of conduct and structuring compensation packages to ensure that there is a reciprocal duty of candor between directors and the CEO.<sup>62</sup> All of these points, like the other proposals, seek to address the main deficiencies in the current monitoring model of the board.

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57. *Id.* at 353 (“On the present board model, well-meaning directors are nonetheless thinly informed . . .”).

58. Although there is no evidence to suggest that companies are pursuing the Gilson and Gordon model, the authors’ original goal was to create an experimental model following the previous experiment, Board 2.0. *Id.* at 354.

59. *Id.* at 361–62 (detailing the costs of implementing the Board 3.0 model, including friction against the company’s current strategy).

60. Faith Stevelman & Sarah C. Haan, *Board Governance for the Twenty-First Century*, 74 *BUS. L.* 329, 338 (2019).

61. See Faith Stevelman & Sarah C. Haan, *Boards in Information Governance*, 23 *U. PA. J. BUS. L.* 179 (2020), for a detailed discussion of this point.

62. Stevelman & Haan, *supra* note 60, at 338–48.

Another potential avenue is Bainbridge and Henderson's Board Service Providers (BSP) Model, a provocative wake-up call that argues boards are not doing what they are supposed to be doing. However, the BSP Model itself will require us to re-imagine where decision-making should rest in corporate law. If the corporation is bound to decisions made by an external firm that is providing board services, then the incentives underpinning such a model would need to be examined in great detail before adopting it.<sup>63</sup> External audit firms have failed to detect fraud in many instances,<sup>64</sup> and it is not clear why a similar model would not give rise to similar failures for BSP firms. On the other hand, the Board 3.0 Model offers an interesting model that firms *might* adopt, although it would require companies to invest resources in restructuring their boards into this model.<sup>65</sup>

This Article will propose a model that uses diversity to strengthen boards, while also ensuring that the diverse board candidates are not over-burdened. Additionally, it will draw on and develop further some aspects of Stevelman and Haan's proposal, particularly those relating to diversity, professionalization, board evaluations, and the director selection process, as well as ideas that emerged from the Netflix Model. The model proposed in Part III of this Article will rely on third-party intermediaries (i.e., executive search firms and other organizations providing supplemental services to the board).

## II. The Promise of Diversity – Addressing Both Sides of the Market

Board diversity is often expected to solve corporate governance and workplace equality problems as if it were fairy dust.<sup>66</sup> In reality, although diversity certainly comes with its benefits, if not properly implemented, it may impose costs on both companies and the

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63. See Gilson & Gordon, *supra* note 47, at 364 (distinguishing the Board 3.0 model from the BSP model); see also Stevelman & Haan *supra* note 60, at 330–38 (critiquing the BSP model and the incentives it creates).

64. See *Accountancy Giants Face Revamp Amid Criticism*, BBC NEWS (Jul. 6, 2020), <https://www.bbc.com/news/business-53307572> [<https://perma.cc/W3ZV-2347>], for a recent example.

65. Gilson & Gordon, *supra* note 47, at 361–63 (discussing the compensatory and reputational costs associated with implementing the Board 3.0 model).

66. See Fairfax, *supra* note 6 (evaluating the harm done by poor implementation of board diversity efforts despite an apparent increase in board diversity).

diverse board candidates being appointed.<sup>67</sup> In this Part, the Article will consider diversity from both sides of the market (i.e., companies on one side and the diverse board members, usually women and members of racial minority groups, on the other).

Companies want to see how their boards may be strengthened by diversity. The discussion in Part I makes it apparent that one of the major problems with the existing board model is the overemphasis on the monitoring function.<sup>68</sup> Another major problem is that the current model has not been successful in fulfilling the monitoring role due to informational disadvantages, a lack of true independence from the CEO, and the inability to exercise independence where it exists.<sup>69</sup> Simply adding diverse candidates to the board will not solve all of these problems. Thus, any proposal to strengthen boards through diversity should be complemented by various other mechanisms, as Stevelman and Haan have done.<sup>70</sup>

As a first step, the benefits of diversity to both the monitoring and operational functions of the board should be explored. The idea that diverse boards are better at monitoring upper management flows partly from the assumption that diverse candidates are more likely to come from different social circles and hence will not hesitate to question management.<sup>71</sup> Furthermore, it is assumed that diverse candidates will bring with them different life experiences, which in turn helps them provide alternative perspectives to the board discussion.<sup>72</sup> The hope is that these different perspectives will help overcome “groupthink,” when members of a cohesive group, striving for unanimity, are unable to realistically appraise alternative courses of actions.<sup>73</sup> However, as

67. *Id.* at 853–54 (concluding that justifying board diversity through business rationales alone may promote unrealistic expectations of business performance and marginalize diverse board members).

68. Most of the problems with the current model stem from the apparent necessity for boards to monitor corporate performance. *See supra* Part I.

69. *See* Stevelman & Haan, *supra* note 61, at 180, 243, 262. This combination of informational disadvantage and inability to exercise director independence exacerbates all the more the problems stemming from the overemphasis of the monitoring function.

70. *See* Stevelman & Haan, *supra* note 60.

71. Nanette Fondas, *Women on Boards of Directors: Gender Bias or Power Threat?*, in *WOMEN ON CORPORATE BOARDS OF DIRECTORS: INTERNATIONAL CHALLENGES AND OPPORTUNITIES* 172–73 (Ronald J. Burke & Mary C. Mattis eds., 2000) (referring to researchers suggesting that “more varied personal and professional backgrounds” of women contributed to more influence over management decisions).

72. AARON A. DHIR, *CHALLENGING BOARDROOM HOMOGENEITY* 157 (2015).

73. *See* Akshaya Kamalnath, *Gender Diversity as the Antidote to Groupthink on*

the interviews of board members of Netflix demonstrate, it is not common for a board to have a culture where dissentient views are encouraged.<sup>74</sup> Relying on diverse board members to overcome a board culture that discourages alternate viewpoints as a means of enhancing the board's monitoring function puts an unreasonable burden on these members.<sup>75</sup>

There is a range of empirical studies showing the impact that women directors have on a number of proxies for monitoring.<sup>76</sup> For instance, in an oft-cited study, Renee B. Adams and Daniel Ferreira found that women directors enhance monitoring.<sup>77</sup> However, evidence suggests that gender diversity had beneficial effects *only* in companies where additional monitoring is required.<sup>78</sup> Thus, the impact of women directors seems to depend on the needs on each firm. In the context of mergers and acquisitions, one study found that women directors were less acquisitive than their male counterparts when pursuing deals.<sup>79</sup> On the other hand, a different study, focusing on banks, found evidence to suggest that more women on boards would not necessarily lead to less risk being taken by banking companies.<sup>80</sup> Since these studies are not unequivocal, this Article will not rely on the empirical literature.<sup>81</sup> Unfortunately, there are not as many studies on the impact of race or other forms of diversity on board monitoring.<sup>82</sup>

It is, however, worth noting that in a qualitative study of Delaware cases examining whether gender diversity improves

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*Corporate Boards*, 22 DEAKIN L. REV. 85 (2017).

74. Larcker & Tayan, *supra* note 34, at 1.

75. See DHIR, *supra* note 72, at 147–72 (concluding from interviews of directors in Norway that the introduction of women directors enhanced board processes).

76. See Deborah H. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?*, 39 DEL. J. CORP. L. 377 (2014) (analyzing multiple studies on board diversity).

77. Renee B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. FIN. ECON. 291, 292 (2009).

78. *Id.* at 292, 307.

79. Maurice Levi, Kai Li & Feng Zhang, *Men are from Mars, Women are from Venus: Gender and Mergers and Acquisitions* 4, 20 (Nov. 2011) (unpublished manuscript) (on file with the American Economic Association), <https://www.aeaweb.org/aea/2012conference/program/retrieve.php?pdfid=191>.

80. Renee B. Adams & Vanitha Ragunathan, *Lehman Sisters* 8 (Sept. 3, 2015) (unpublished manuscript) (on file with SSRN), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2380036](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2380036).

81. See Kamalnath, *supra* note 8, for a summary of empirical studies specifically linking diversity to the board's monitoring function.

82. This illustrates a limit on the current research of the impact board diversity has on corporate performance. More research needs to be done to properly evaluate the likely beneficial impact diversity has on governance.

corporate governance, this author found that in some cases where the company had women directors, their decision-making was not very different from their male counterparts.<sup>83</sup> This is probably because the women had C-Suite experience and as a result did not bring with them a remarkably different perspective, at least in the context of the acquisition the decisions were about.<sup>84</sup>

In another case, two newly appointed directors, not diverse in terms of gender, questioned the board's decision not to fire the CEO in the face of a crisis.<sup>85</sup> This was possibly attributable to the fact that they were newly appointed to the board after the company had already received negative publicity.<sup>86</sup> Thus, board members who belong to different social groups/networks and newly appointed directors are likely to be better monitors, irrespective of their gender or race. This adds weight to the adoption of soft term limits for board directors, which was part of Stevelman and Haan's proposal.<sup>87</sup>

The same study of Delaware cases also found that when the same person held both the position of CEO and board chair, the board's ability to monitor management effectively was impaired.<sup>88</sup> This is again consistent with Stevelman and Haan's proposal.<sup>89</sup> However, the study goes on to note that the CEO and his "inner circle," all of whom were male and had worked together for a long time, within the management team seemed to be aware of and involved in the illegal activities carried on in the company.<sup>90</sup> This indicates the need for diversity within management teams and executive directors as well.<sup>91</sup> Furthermore, as the interviews of the Netflix directors show, the CEO must prioritize a culture within both the board and management teams that allows open discussion and transparency.<sup>92</sup>

83. Kamalnath, *supra* note 8, at 115.

84. *Id.*

85. *Id.* at 113.

86. *Id.* at 116.

87. Stevelman & Haan, *supra* note 60, at 343; *see also* Yaron Nili, *The "New Insiders": Rethinking Independent Directors' Tenure*, 68 HASTINGS L.J. 97 (2016) (proposing that the increase in average director tenure is a direct response to independence requirements that lead companies to seek new directors).

88. Kamalnath, *supra* note 8, at 116.

89. Stevelman & Haan, *supra* note 60, at 343.

90. Kamalnath, *supra* note 8, at 80, 116–17.

91. *Id.* at 80; *see also* Afra Afsharipor, *Bias, Identity and M&A*, 2020 WIS. L. REV. 471, 484–85 (2020) (observing that increased gender diversity on boards is associated with "more vigorous board monitoring").

92. Larcker & Tayan, *supra* note 34, at 4.

Thus, while diverse directors are valuable, that diversity should not be restricted to independent directors. Liminality (i.e., outsider status) also plays an important role in monitoring ability, so periodic board refreshment is necessary.<sup>93</sup> Finally, the CEO should be invested in improving the board and top management culture. Such changes will help facilitate the free flow of information from management to the board and advice from the board to management.<sup>94</sup> The question then is how companies, and more specifically CEOs, may be incentivized to introduce such changes. The model proposed in Part III below seeks to address this.

The other side of the market consists of the diverse potential board and top management members. Women and members of minority racial groups will be the main focus of this discussion, but there will be some mention of members from different experiential backgrounds. While a lot of literature has been devoted to how diversity benefits companies,<sup>95</sup> not nearly as much literature has focused on why diverse candidates might want to serve as board directors or even remain in the workforce in executive roles.

Often businesses and law firms lament that the pool of diverse candidates is too shallow,<sup>96</sup> but recent diversity databases show that this is simply not the case.<sup>97</sup> Instead, it is likely that women and minority candidates are opting out of workplaces where racism, sexism, bullying, and discrimination are prevalent.<sup>98</sup> Similarly, potential board members would likely want to opt out of boards where they are merely hired as tokens to signal that the company cares about diversity, rather than as members whose contributions are valued. In one study, women directors said that they were not treated as full members of the group and that “many male directors seem unaware that they may create hostile board cultures, fail to listen to female directors or accept them as equals, and require them to continually reestablish their credentials.”<sup>99</sup>

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93. Kamalnath, *supra* note 8, at 26.

94. *Id.* at 110–11.

95. *See* Kamalnath, *supra* note 8.

96. *See* Eli Wald, *In-House Myths*, 2012 WIS. L. REV. 407, 456 (2012).

97. *See, e.g.*, Derek T. Dingle, *Power in the Boardroom: Registry of Black Corporate Board Members*, BLACK ENTER. (Sept. 18, 2018), <https://www.blackenterprise.com/registry-black-corporate-board-members-2018/> [https://perma.cc/X3D4-9QDS].

98. Cheryl L. Wade, *Gender Diversity on Corporate Boards: How Racial Politics Impedes Progress in the United States*, 26 PACE INT'L L. REV. 23, 34 (2014).

99. Boris Groysberg & Deborah Bell, *Dysfunction in the Boardroom*, HARV. BUS. REV. (June 2013), <https://hbr.org/2013/06/dysfunction-in-the-boardroom>

There is also the issue of “glass cliffs,” in which women and racial minorities are appointed only when a company is facing a crisis.<sup>100</sup> In any kind of crisis, but especially when the crisis involves an issue of sexual harassment or unaddressed racism, a newly appointed director who is a woman or a member of a racial minority faces more scrutiny. For instance, when Ariana Huffington was appointed to the board of Uber after the allegations of sexual harassment created a reputational crisis for the company, some news articles discussed her appointment with negative undertones.<sup>101</sup> Similarly, in response to the Black Lives Matter movement, Reddit appointed a Black director to their board.<sup>102</sup> Especially with appointments that are made in response to high publicity events about company-specific or systemic injustices, it becomes increasingly important for these diverse candidates to be able to make informed assessments about the culture of the board and the wider company.

Being part of a board that does not in fact facilitate discussions of different perspectives means that diverse candidates will likely be unable to truly influence the board’s decisions.<sup>103</sup> Further, to have an impact on issues like harassment and discrimination, directors need to perform both monitoring and advisory roles. It is then important to know whether the CEO and board culture facilitates such involvement. Such information will allow board candidates to assess whether they will be able to make a real contribution to the company. This is particularly important for diverse candidates who are hired in the context of social pressure

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[<https://perma.cc/ZGK7-HGRJ>].

100. Douglas M. Branson, *Pathways for Women to Senior Management Positions and Board Seats: An A to Z List*, 2012 MICH. ST. L. REV. 1555, 1568 (2012); Terry Morehead Dworkin, Aarti Ramaswami & Cindy A. Schipani, *A Half-Century Post-Title VII: Still Seeking Pathways for Women to Organizational Leadership*, 23 UCLA WOMEN’S L.J. 29, 46 (2016).

101. See, e.g., Katerina Ang, *Can Arianna Huffington Help Uber Recover from Sexual Harassment Claims?*, MARKET WATCH (Mar. 24, 2017), <https://www.marketwatch.com/story/can-arianna-huffington-help-uber-recover-from-sexual-harassment-claims-2017-03-24-9884450> [<https://perma.cc/246D-RVZR>].

102. Isabel Togoh, *Michael Seibel Becomes Reddit’s First Black Board Member After Alexis Ohanian’s Resignation*, FORBES (June 10, 2020), <https://www.forbes.com/sites/isabeltogoh/2020/06/10/michael-seibel-becomes-reddits-first-black-board-member-after-alexis-ohanians-resignation/#5e551498430a> [<https://perma.cc/9J7X-J6MG>].

103. Dirk-Jan Van Veen, Ravi S. Kudesia & Hans R. Heinimann, *An Agent-Based Model of Collective Decision-Making: How Information Sharing Strategies Scale With Information Overload*, 7 IEEE TRANSACTIONS ON COMPUTATIONAL SOC. SYS. 751, 765 (2020) (finding that diversity alone will not improve decision-making in a team if the team cannot “leverage the wisdom of disagreement”).

resulting from social movements like #MeToo and Black Lives Matter, since the expectation seems to be that these candidates will help address problems of sexism and racism within the firm. If candidates are in fact able to make such assessments, then companies will also be incentivized to pay attention to these issues in order to attract more diverse candidates. This presents the issue of how a potential director may be assisted in making these assessments accurately. This will be addressed in the model proposed in Part III below.

What this Part II has described is a classic two-sided market where companies want to appoint diverse candidates, either to signal their commitment to social issues or to genuinely improve governance, and diverse candidates want the ability to accurately assess boards before joining them. As the next Part will show, third-parties providing supplemental board services, like board evaluations and executive and director search functions, are well-suited to service this two-sided market. In doing so, shareholders and other stakeholders stand to gain as well.

### III. Reliance on Third-Party Intermediaries

Third-party providers of supplemental board services like executive and director searches and board evaluations are already being used by companies.<sup>104</sup> Omari Scott Simmons notes that executive search firms act as intermediaries in the labor market for executive talent since they facilitate transactions between companies and potential executives.<sup>105</sup> The executive search firms are able to fill information gaps between these two parties; however, as any third-party involvement naturally does, they do come with costs.<sup>106</sup> The fact that companies are using them indicates that the benefits exceed any costs.<sup>107</sup> For diverse candidates, the benefits are even more valuable, and the costs presumably stay the same, making acceptance of the costs much easier.

Executive search firms not only “research, identify, screen, interview, verify candidate qualifications, and engage in final offer negotiations,” but also provide “leadership consulting, succession

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104. See Omari Scott Simmons, *Forgotten Gatekeepers: Executive Search Firms and Corporate Governance*, 54 WAKE FOREST L. REV. 807 (2019).

105. *Id.* at 815.

106. *Id.* at 816.

107. *Id.* at 817–19 (establishing that, amongst other things, the benefits to the company include signaling good governance practices and shifting accountability).

planning, and board assessment” services.<sup>108</sup> Interestingly, the larger executive search firms also offer “culture shaping.”<sup>109</sup> Recently, one of the big executive search firms bought a leadership consulting firm to consolidate its “culture shaping” offering.<sup>110</sup> The use of these executive search firms appears to be extensive: within the director hiring process, executive search firms “on average recommended 22.7% of independent directors to the board.”<sup>111</sup>

The recent emphasis on diversity in boards, coupled with pressure from social movements, indicates that executive search firms are likely to be used more frequently in the coming days.<sup>112</sup> According to the board search guiding principles of the self-regulating Association of Executive Search and Leadership Consultants (AESC), diversity is already one of the factors that executive search firms engage with during the board consultation process.<sup>113</sup> On the company’s side, executive search firms work to manage unconscious bias, while at the same time preparing candidates by briefing them about the company’s culture and strategy.<sup>114</sup> Relatedly, they also focus on board refreshment practices and succession planning.<sup>115</sup>

Executive search firms like the AESC also consult with boards to provide advisory services which include assessing board culture, creating an inclusive board culture, inducting new board members, improving the relationship between the CEO and the board, and clarifying the roles of the board, its committees, and its members.<sup>116</sup> Crucially, it also includes board evaluation services.<sup>117</sup> While board evaluation is not a new idea, most company boards only conduct a

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108. *Id.* at 820.

109. *Id.* at 825–26.

110. See *Heidrick Buys ‘Culture Shaping’ Firm for \$53 Million*, STAFFING INDUS. ANALYSTS (Jan. 3, 2013), <https://www2.staffingindustry.com/site/Editorial/Daily-News/US-Heidrick-Buys-Culture-Shaping-Firm-for-53-Million-24168> [<https://perma.cc/486L-9M3E>].

111. Ali C. Akyol & Lauren Cohen, *Who Chooses Board Members?*, in *ADVANCES IN FINANCIAL ECONOMICS* 43, 14 (Emerald Publ’g Ltd. 2013).

112. See Ang, *supra* note 101; Togoh, *supra* note 102; Branson, *supra* note 100; Dworkin, *supra* note 100; ASS’N OF EXEC. SEARCH AND LEADERSHIP CONSULTANTS, *AESC BOARD SEARCH & ADVISORY SERVICES GUIDING PRINCIPLES 2–3* (AESC ed., 2016).

113. ASS’N OF EXEC. SEARCH AND LEADERSHIP CONSULTANTS, *supra* note 112.

114. *Id.* at 4.

115. *Id.* at 3.

116. *Id.* at 5.

117. *Id.*

self-assessment.<sup>118</sup> Outsourcing it to a third-party firm can bring objectivity into the process. Since these same third-party firms also act as intermediaries for director appointments, the evaluations can be used as an important metric for candidates to assess the company. Thus, executive search firms, through the range of supplemental board services they provide, are already acting as intermediaries between boards and candidates for board directorships.

To ensure that these intermediaries are efficiently serving both sides of the market, it is necessary for them to focus their evaluations of company culture on issues that diverse board members might find particularly challenging. As discussed earlier in this article, important questions like whether dissentient views are frowned upon, or whether board members have timely access to information,<sup>119</sup> should be included in the evaluation metrics. These issues speak to a board's culture and diverse directors will particularly value these metrics when making decisions. Even information about the companies' board refreshment policies and succession planning can be useful to potential candidates in assessing the culture of the board. The more refreshment there is, the more open the board is to hear from newer members.<sup>120</sup> These factors might also help candidates who fulfill other facets of diversity (e.g., those from a different experiential background) to decide whether to take on the board position.

Further, under the current monitoring board model—since diverse board members usually bear the burden of being appointed after a human crisis (e.g., harassment, bullying, etc.) within the company or a social movement drawing attention to systemic problems—diverse directors cannot afford to be as under-committed to the company as many other independent directors currently are. Eventually, greater involvement of diverse directors, coupled with pressure from intermediaries providing board advisory services, has the potential to change the expectations for all independent directors.

Even though executive search firms provide numerous advantages, it is not advisable for regulators to require companies to engage them for director nomination, board evaluation, and other

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118. See N.Y. STOCK EXCH., LISTED COMPANY MANUAL SECTION 303A CORPORATE GOVERNANCE STANDARDS 1–14 (NYSE ed., 2004) (requiring companies to conduct self-evaluations at least annually).

119. Kamalnath, *supra* note 8, at 113, 118.

120. *Id.* at 118.

board advisory services. It is likely that mandating board evaluation exercises would result in tick-the-box compliance rather than genuine investment in the process.<sup>121</sup> A better approach would be the creation of a market driven process in which the demand for board diversity results in intermediary firms refining their board evaluation processes based on the needs of diverse candidates. That said, the informational needs of diverse candidates is an under-researched issue that needs to be highlighted. Once the importance of board evaluation reports and their positive link to board diversity is understood, institutional investors, many of whom are already active on the diversity agenda, will begin to engage with companies requiring disclosure of board evaluation reports on these lines. Executive search firms would be able to exclude confidential information and provide a version of the report that is easily digestible for outsiders. Proactive companies could even start to make these reports available on their company website so that they are available not only to potential board members and investors, but also to the wider society.

### Conclusion

This Article has attempted to address board diversity and board effectiveness in conjunction, because the former has potential to address the latter. However, it is not as simple as adding some diverse directors to the board and expecting governance problems to be resolved. There are serious problems with the current monitoring model of the board and, while it may be tempting to assume that diversity is an easy fix, it is time to realize that diversity will only be useful when complemented by other measures. The model proposed in this Article offers a solution to help both companies and diverse directors.

This Article has also reviewed a number of new board models, some as drastic as outsourcing the board entirely.<sup>122</sup> It has reviewed and drawn from less drastic models, such as the one proposed by Stevelman and Haan<sup>123</sup> and the one already in use at Netflix.<sup>124</sup> The Board 3.0 Model offers a good blueprint for adoption by companies

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121. See Luca Enriques & Dirk Zetsche, *Quack Corporate Governance, Round III: Bank Board Regulation Under the New European Capital Requirement Directive*, 16 THEORETICAL INQUIRIES L. 211, 212 (2015).

122. Bainbridge & Henderson, *supra* note 1, at 1056.

123. See Stevelman & Haan, *supra* note 60.

124. See Larcker & Tayan, *supra* note 34.

and could work in conjunction with the intermediary model suggested in this article. The model proposed here is also significant because it emphasizes the needs of diverse board members, which has generally been an under-researched area in corporate governance. In future research, this author hopes to empirically support the model proposed in this Article by interviewing diverse directors about the factors they considered before joining company boards, as well as what factors they might consider in the future.