A LEADERSHIP REPOSITORY FOR BOARDS OF DIRECTORS

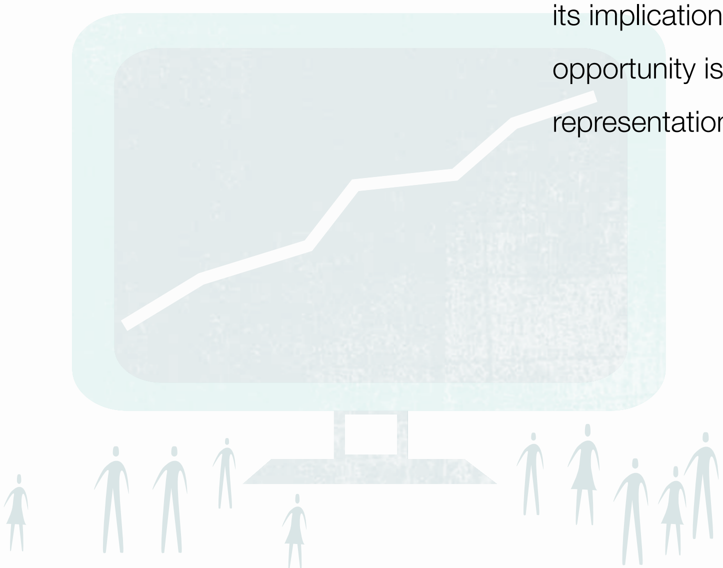
by Victor Arias and Carlos Garcia

Addressing the $1.2 trillion issue of Hispanic representation on U.S. boards

As the scrutiny of corporate boards of large U.S. companies intensifies, it has become clear that something is missing from the governance picture: Hispanic directors.

Hispanic Americans, who represent 14 percent of the United States population, occupy only 2.3 percent of the total board of director seats among Fortune 1000 companies. Only 19 percent of Fortune 1000 boards have a Hispanic director, a percentage that has barely budged in the past nine years, a period when the country's Hispanic population – and the Hispanic consumer market (HCM) – increased dramatically.

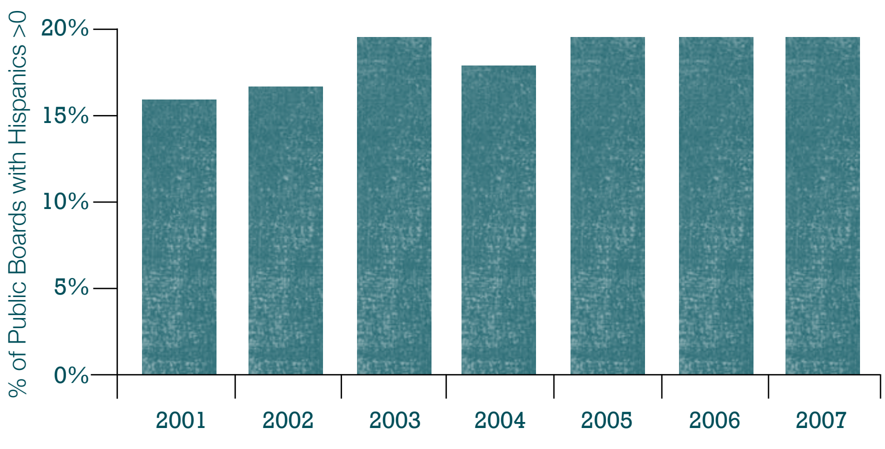
On first blush, this gap might appear to be a "diversity" matter; however, its implications extend far beyond traditional equal employment opportunity issues. A closer inspection reveals that Hispanic representation on Fortune 1000 company boards qualifies as a



pivotal business and governance concern. Boards and nominating committees that address this leadership gap reap employer-of-choice, talent-management, labor relations, corporate governance, risk management and, above all, bottom-line benefits for their shareholders.

Hispanic Leadership Gap Lingers

Percent of Fortune 1000 Companies with a Hispanic Director



Source: Korn/Ferry's 34th Annual Board of Directors Study (891 F1000 companies)

Steve Reinemund is a corporate director for American Express, Marriott and Exxon Mobil; the dean of Wake Forest University's business schools; and the former CEO of PepsiCo. He notes that companies "need to represent the marketplace that they serve, or want to serve, from the boardroom to the front lines. I don't believe you can start from the front lines. I think you need to start in the board room and go to the front lines."

Doing so can be a challenge due to several obstacles, including: a preference for a narrower set of director competencies in the new regulatory era, lingering misconceptions about the Hispanic market, a tough director recruiting environment and, equally important, flaws in the directorship search and selection process.

This white paper focuses squarely on the business and governance implications of the Hispanic representation gap within the ranks of U.S. publicly held corporations.

In doing so, the paper helps nominating committee members and other corporate directors understand and address these challenges so that they can more effectively access the business and governance benefits associated with eliminating a risky leadership gap on their boards.

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An Increasingly Influential 'Crosscurrent'

Amid the rapid pace of change and upheaval currently confronting organizations, one certainty exists: corporations and the boards that help govern and oversee them can expect to play under new rules in a wide range of activities.

Boards must contend with a much more active regulatory environment sparked by misdeeds at Enron and other companies earlier this decade as well as more recent, and more damaging, decision-making on Wall Street. Boards also must address a surging demand for sustainable business practices, the onward march of globalization and technology, and major demographic shifts in the U.S. and other parts of the world. Addressing these issues requires much more of corporate directors than the financial literacy skills that were in such high demand on the heels of the Sarbanes-Oxley Act seven years ago. While financial reporting acumen remains a necessary and extremely valuable board competency, it is far from the only competency that boards require amid rapidly changing business, political and demographic conditions.

Increasingly, nominating committees want directors who can sufficiently grapple with healthcare, human rights, sustainability, emerging markets and government relations issues (see *A New Breed of Directors Emerges as Public Policy Enters the Boardroom,* a 2009 Korn/Ferry Institute whitepaper.) "Individuals who have had direct responsibility in areas important to the company and have a regulatory perspective are valuable," notes Vic Fazio, a former Congressman who currently sits on the board of Northrop Gruman Corp. "It is an additional benefit if these people bring gender or ethnic diversity to a board."

The need for diverse experience and perspectives in the boardroom increases as more companies ride the globalization wave while simultaneously navigating crosscurrents of regional nuances and

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even individual identities. In our "hyper-connected" world, principled performance advocate and BusinessWeek columnist Dov Seidman notes, "multinational companies commonly form teams of employees chosen from various divisions, various countries and various cultures … opportunity conjoins us faster than we have developed frameworks for understanding each other and getting along."

The growing economic and political influence of the Hispanic market represents a crucial crosscurrent for U.S. companies in all sectors. The business implications of a growing U.S. Hispanic population, projected to surpass 63 million by 2020, are significant.

"Ten years ago the Fortune 1000 were advised to keep an eye out for the Hispanic market as an up-and-comer," says Jeff Valdez, founder and director of Si TV, director of QuePasa.com and co-chairman of Maya Entertainment. "Five years ago they were told this market could help their bottom line. Now, it would be prudent to look at the proper understanding of, and effective marketing to, this audience as the potential difference between a profit and a loss."

By 2011, U.S. Hispanic buying power is expected to exceed $1.2 trillion; this figure represents a 450-plus percent increase in purchasing power since 1990. By comparison, non-Hispanic purchasing power in the U.S. increased by 176 percent between 1990 and 2011. Boards increasingly need the awareness, innovation and authenticity of the Hispanic perspective to help ensure that their companies can take advantage of revenue-growth, talent management and community partnership opportunities (see "A Trillion-Dollar Business Case" side bar.)

"The U.S. is rapidly becoming a very diverse and global country. I think that the 2010 census will confirm that a major change has taken place just in the past decade," notes Carlos F. Orta, president and CEO of the Hispanic Association on Corporate Responsibility (HACR). "Hispanics not only wield $1 trillion in buying power, they also represent 50 to 55 million consumers – people who purchase toothpaste, diapers, banking services and a wealth of other products and services."

While these market drivers point to an attractive business case for addressing the Hispanic director leadership gap, other, less formal reasons exist.

"I spent a lot of time in my early years as a CEO trying to prove the business case [for a more diverse board and executive team], which is really not that difficult to do numerically," recalls Reinemund of his PepsiCo tenure. "In a number of specific examples, we did prove that if you change the diversity makeup, you can improve business results. But we also backed up and realized that it didn't really need to be quantified. If you are trying to serve a diverse population without people who understand the market research, possess the right instincts and have the ability to help you develop a product and interact with people you sell to, you are not going to be successful. At the end of the day, it really is more a matter of common sense."

A Trillion-Dollar Business Case

The revenue-growth opportunity within the U.S. Hispanic market is massive – and growing; in fact, it represents the most important of three drivers behind the need for greater Hispanic directorship representation on Fortune 1000 boards:

- Product of Choice: The U.S. Hispanic market will soon wield more than $1.25 trillion in purchasing power, and the population is steadily growing. Young Hispanics currently represent 20 percent of the total U.S. teen population; marketing experts have described this rising demographic as "extroverted, outgoing, outspoken and, above all, wired." There is also mounting evidence that the Hispanic consumer market is a "healthy landscape for consumer spending compared to Anglo markets" during recessions, as companies like Pepsi and McDonald's have demonstrated in the current and previous downturns. Companies and boards that neglect "The New American Mainstream" will likely lose "product and service of choice" opportunities – and market share – to competitors who understand the market.

A Trillion-Dollar Business Case, *Continued*

- Employer of Choice: Many Hispanic business leaders cannot be identified and recruited through traditional networks. Additionally, the recruiting environment for corporate directors has grown more challenging as governance and regulatory scrutiny intensifies. The boards and companies that forge relationships with Hispanic directors, executives and future executives today will be better positioned to compete for increasingly valuable managers, executives and directors in the future as the influence of the Hispanic market grows.
- Community Partner of Choice: To gain the credibility required to become an employer of choice and a company that provides products of choice to the Hispanic consumer market, companies must establish and strengthen their visibility in Hispanic communities. This requires engagement with the community and stakeholder organizations.

'Too New, Too Different, Too Difficult'

Given the valuable business case as well as the common-sense argument mentioned above, why has the percentage of Hispanic directors at large U.S. companies remained so low for so long?

There are a number of concrete reasons for this leadership gap; most of them boil down to a prevailing sentiment that Hispanic representation on Fortune 1000 boards has been an issue that feels "too new" or "too different" or "too difficult."

"Too new" often refers to a belief that an industry remains unaffected by the growing U.S. Hispanic market. "Too different" refers to the discomfort some hiring committees and recruiting specialists expect to encounter when expanding the search process to include Hispanic candidates. And "too difficult" relates to a perception that Hispanic directorship candidates cannot be found or, more fundamentally, do not exist.

Each of these reactions is flawed.

First, every industry, not just consumer-oriented products and services, is influenced by the growing U.S. Hispanic market. Supply chain, labor, talent management and corporate governance issues related to the Hispanic market exist in nearly every industry. Second, while traditional board search processes often require adjustments to include appropriate Hispanic candidates, these adjustments are attainable with the right approach and know-how. Third, qualified and appropriate Hispanic directors exist; they commonly operate outside of traditional corporate sectors on boards of large, privately held companies; boards of trustees, corporate advisory boards; the boards of large foundations and nonprofit organizations; private equity boards; in academia; in the legal profession; and in executive government positions.

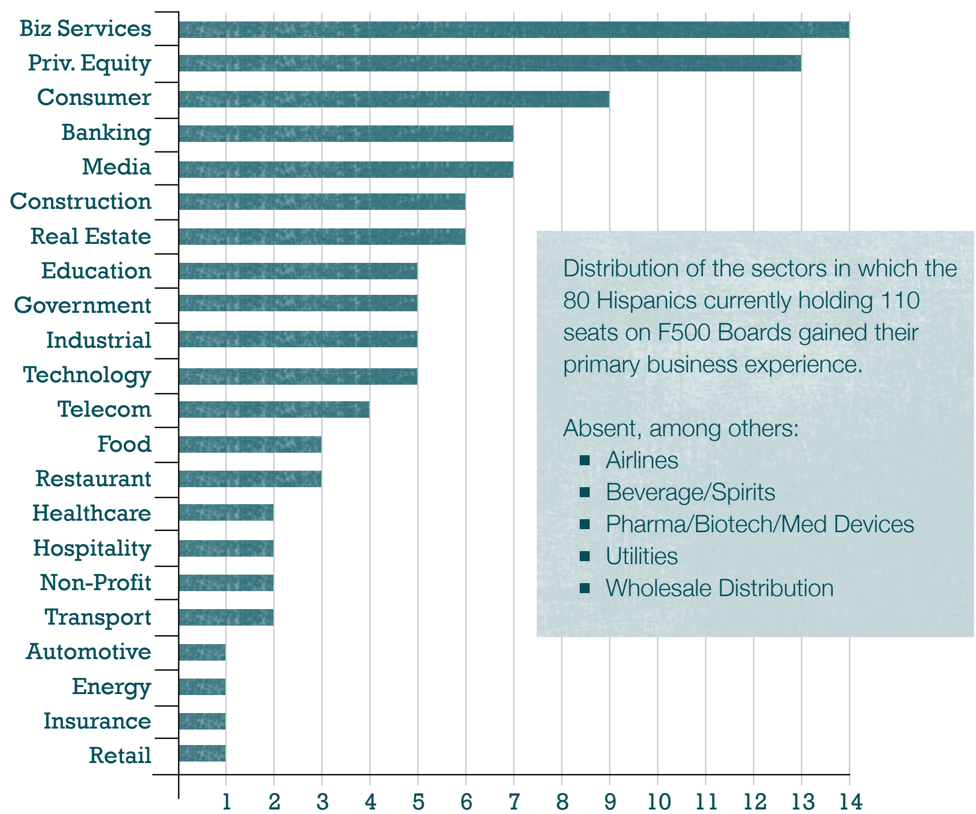
Other trends and obstacles also limit the growth of Hispanic representation on Fortune 1000 boards, including:

- Lingering Misperceptions: "There is a continuing misperception as to who Hispanics are and an on-going challenge in defining Hispanics to members of boards and corporate leaders," notes a current director of two Fortune 1000 boards. "The Latin American executive differs from an American Hispanic – and many boards do not recognize this difference. They believe that if they've brought in a Mexican national or an Argentinean executive, they've got their Hispanic." An Argentinean executive, for example, may have very little understanding of the U.S. Hispanic market and its complex composition.

- Narrower Search Specifications: Since the passage of the Sarbanes-Oxley Act, search specifications for open board seats have grown narrower and more rigid, almost to a myopic degree in some cases. For example, the governance mandate for "financial literacy" on the board often translates in practice to a search that frequently concludes with a current or former CEO or CFO or a retired Big 4 auditing firm partner. Financial literacy, a must-have board competency to be sure, is possessed by many leaders, and not only CFOs, Big 4 auditors and audit committee veterans.

- A Challenging Recruiting Environment: The new regulatory era ushered in by Sarbanes-Oxley and the current administration's push for greater governance transparency has created an understandable perception that board service now comes with greater risk. The directorship recruiting environment has grown more difficult because many qualified and appropriate candidates have grown less inclined to take on directorship roles.

Sectors that produced current Hispanic directors



Number of Hispanic CEO's or Directors on Boards of Other Industry Sectors

Source: Hispanic Business 2009 Boardroom Elite; KFI analysis

Strengthening the Selection Process

There are three actions boards can take to work through the challenges that have contributed to the unusually low Hispanic representation on Fortune 1000 boards for so many years. These steps include:

1. Redefining the specifications.

By creating excessively narrow specifications for director searches, nominating committees and their external advisors eliminate qualified and appropriate Hispanic business leaders from consideration. Expanding the search specification calls for, and also helps engender, what has been described as “business-cultural fluency.” Business-cultural fluency requires “inclusion,” which differs from “representation.” Inclusion is a “reciprocal arrangement” that stimulates the exchange of ideas and knowledge among intellectual peers on a board of directors. This intellectual tug of war is designed to inject specific and deep market knowledge into the board’s discussions of competitive strategy, market success, leadership development, risk management and corporate governance. Boards that demonstrate business-cultural fluency can help their companies avoid the tailoring of products and services to the Hispanic market in a tone-deaf way that demonstrates shallow cultural awareness and, ultimately, can result in brand and reputation devaluation. (Consider Chevy’s classic misstep in failing to adapt its Nova – which translates to “no go” – marketing campaign to the Hispanic market.) Further, business-cultural fluency creates a valuable byproduct: credibility. Credibility helps strengthen stakeholder relations while enabling the board to provide more effective oversight with regard to the revenue-growth, talent management and community partnership opportunities described earlier.

2. Modifying the search process to include more finalists.

Historically, board searches have produced a single finalist candidate. Increasing the number of finalist candidates interviewed by the nominating committee serves two valuable purposes. First, it helps expose a greater number of suitable candidates to the board. Second, it helps boards build their pipeline of Hispanic candidates for future board appointments. Many nominating committees have begun to adjust their search processes in this way; these boards will be better positioned as the competition for Hispanic directors, and Hispanic executives, intensifies.

3. Taking greater responsibility.

Individual directors can take greater responsibility for bringing candidates, including Hispanic candidates, to the nominating committee. In this area, organizations such as HACR can provide assistance. HACR maintains a database of qualified Hispanic business leaders who are either currently serving on boards or who possess the experience, business acumen and educational background that Fortune 1000 board service requires. The organization also operates a corporate directors’ council comprised of more than a dozen Hispanic Fortune 500 directors; participates in the Alliance for Board Diversity; and hosts an annual summit for Hispanic directors.

Search Firm Leadership

External search consultants also bear responsibility for strengthening the directorship search process. "Search firms frequently tend to take the easier, safer route and want as narrow a spec as possible," notes Gilbert Casellas, a member of the board of directors of Prudential.

Narrow search specifications produce a highly familiar slate of candidates (e.g., current or former CFOs or a former head of an audit committee). Additionally, there are few Hispanic leaders within the set of "current or former CFOs or a former head of an audit committee." And "recycling" those leaders as candidates is difficult because many of them already serve on one, two or more corporate boards.

A more holistic directorship search process is required to address the Hispanic leadership gap. "Persuade your board to interview at least four candidates as opposed to one leading candidate," suggests Pastora San Juan Cafferty, a corporate director for Integrys and Waste Management. "And include the CEO in the interviewing process. The result may surprise you."

Recently, a growing number of boards have expressed a desire to interview more than one finalist director candidate. Interviewing several candidates can expose current board members to a broader and more varied collection of leaders to consider for future vacancies. Doing so is a matter of candidate care: the sensibilities of candidates interviewed but not selected must be managed with care throughout this more active selection process.

In addition to ensuring that a greater number of directors participate in or monitor the selection process, the board's traditional competency identification and review process should be reexamined. The competency assessment should result from a critical review of the current directors' capabilities and experiences: *What skills already exist on the board? What leadership gaps exist? And, how can the search for a new director fill these gaps?*

Finally and perhaps most important, when identifying candidates who possess the sought-after competencies, nominating committees and their external advisors should be mindful of the difference between a candidate who is qualified and a candidate who is appropriate.

All candidates must be qualified, of course. They must possess the competencies the board has identified it wants the incoming director to possess; in short, each candidate must meet the terms outlined in the search specification. However, a qualified candidate may not be the best fit. CEO and audit-committee experience does not mean that candidate necessarily brings a nuanced understanding of other strategic issues vital to the board's oversight.

Neglecting the appropriateness of a candidate's fit also can prevent search consultants and nominating committees from considering less traditional experiences that demonstrate specified competencies. For example, a business leader can amass corporate governance experience and financial literacy expertise while serving on the board of a large non-profit or serving as an executive of a private company. Similarly, the general manager of a $2 billion business within a conglomerate may have just as much leadership experience as the CEO of a similarly sized company.

The Science of Search Expands

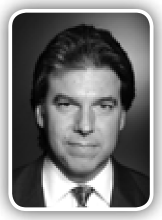
Fortunately, the need to pursue broader, more inclusive directorship searches coincides with a trend toward more holistic and more rigorous executive searches. In the past, many executive searches hinged on resume qualifications and how the candidate performed during the interview process. Today, those evaluation criteria can be complemented by much more scientific assessments of behavior, leadership styles and decision-making dynamics.

By reexamining their director-selection process, nominating committees and boards can better ensure that they are providing the leadership that a rapidly changing marketplace requires, and that their shareholders demand.

"Without diversity on the board it is very difficult for the CEO to come up with a strategy for the company that is going to be appropriate," Reinemund adds.

The vast majority of Fortune 1000 companies confront strategic opportunities influenced by the rapidly growing U.S. Hispanic market and population. As a result, nominating committees that succumb to a "too new, too different, too difficult" reaction to the need for addressing the Hispanic directorship gap may ultimately have to share some bad news with their shareholders – that they were "too late" in responding to a crucial crosscurrent in ongoing competition for market share and leadership talent.

Victor Arias, Jr. is a Senior Client Partner and co-head of the Real Estate Sector within the Global Financial Market of Korn/Ferry International and also specializes in consumer and board services recruitment efforts. He co-chairs Korn/Ferry International's Hispanic Business Initiative and is based in Dallas.



Carlos Garcia is a Senior Client Partner in the Supply Chain Management Practice of Korn/Ferry International and a functional specialist in operations with experience across multiple industry sectors. He co-chairs Korn/Ferry International's Hispanic Business Initiative and is based in Los Angeles.

About The Korn/Ferry Institute

The Korn/Ferry Institute was founded to serve as a premier global voice on a range of talent management and leadership issues. The Institute commissions and publishes groundbreaking research utilizing Korn/Ferry's unparalleled expertise and preeminent behavioral research library. It also serves as an exclusive destination for executives to convene and hone their leadership skills. The Institute is dedicated to improving the state of global human capital for organizations of all sizes around the world.

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