Corporate Secretary
GOVERNANCE • RISK • COMPLIANCE

Boardroom makeover

April 8, 2014 | By Sheryl Nance-Nash

With shareholders more focused on diversity, director skill sets and tenure, boards need to overcome impediments to renewal

Increasingly, corporate boards are taking a long look in the mirror, and many are concluding that they are in need of a makeover. It's no surprise, then, that the latest buzz in the corporate governance world revolves around board renewal.

But what is board renewal? There's no hard and fast definition, but it's all about reinvigorating a board by bringing in new members with up-to-date skills or experiences, adding greater diversity or generally making sure it's not behind the times, given the challenges the company faces now and is likely to face in the future. Board composition is a hot topic in the corporate governance world. 'It's a mega-issue and it's going to get even more attention,' says Don Keller, partner at PwC's Center for Board Governance.

There's a confluence of factors fueling the fire. In an increasingly challenging regulatory landscape, boards are being called upon to provide forward-looking strategic counsel and rigorous oversight while facing greater public scrutiny from a variety of stakeholders and grappling with a volatile economic climate, says Allie Rutherford, director of corporate governance at the EY Center for Board Matters. 'A 'check-the-box' compliance approach from directors who think, act and look alike will not meet the complex challenges facing today's firms,' she warns.

As boards come under more pressure, some investors are prioritizing board diversity and more closely assessing whether overall board composition reflects the firm's strategic direction, regulatory developments, challenges and transformation, observes Rutherford. Investors are also increasingly concerned that lack of turnover and lengthy board tenure may compromise board independence.

A recent EY report finds that 45 percent of board seats are held by individuals with a tenure of 10 years or more, 88 percent of them men. Around 27 percent of current board seats could turn over in the next five years. Men account for 94 percent of seats held by directors aged 68 and older.

Reasons for renewal

The truth is, it's not only activist shareholders who may be uncomfortable with who's in the directors' seats. Around 35 percent of directors polled in PwC's 2013 Annual Corporate Directors Survey say someone on their board should be replaced (compared with 31 percent in 2012). Why are they ready to get rid of their peers? Diminished performance because of aging, a lack of required expertise and poor preparation for meetings are among the top reasons.

Areas where directors fall short include their understanding of new technologies, diversity of thought, true understanding of global trends and operations, insight into the potential of new developments such as big data analytics, understanding of threats such as cyber- crime – and the list goes on, says Rita Gunther McGrath, a professor at Columbia Business School and author of the book *The end of competitive advantage*.

Directors have faced increasing shareholder discipline through negative votes on proxy ballots that are highlighted in the media. Board renewal marks a decision by the board to respond to this trend by proactively reviewing its members and sometimes taking action where needed. 'It is essentially a decision to move from ex post corrections after problems have been pointed out to ex ante prevention,' says Lori Verstegen Ryan, director of the Corporate Governance Institute at San Diego State University.

For all the dissatisfaction, though, replacing a fellow board member can be difficult, according to the respondents to PwC's survey. And of all the impediments, directors most often cite board leadership's discomfort with addressing the issue.

‘It’s hard to throw granny off the bus,’ says McGrath. ‘Many board members are respected, likeable, well-pedigreed people who just don’t have the up-to-date skill set to be effective. How do you move them along to bring on people with the right skills?’

What do boards want?

As boards do a makeover, what matters most? According to the PwC survey, boards are primarily looking for industry, financial, operational, risk management, international and technology/digital expertise.

It’s a new world order, and boards need to reflect that. ‘With the global marketplace, the board has to have global representation, so more and more boards are trying to attract directors from other parts of the world where their firms do business,’ explains Daniel Sweeney, director of the Institute for Enterprise Ethics at the Daniels College of Business, University of Denver.

Boards love to have sitting CEOs on their boards, but that has its downside. ‘If the CEO’s own firm has a crisis, he or she can be fried with all the responsibilities,’ says Sweeney. ‘It can be hard to find quality directors.’

Five to 10 years ago, boards would typically wait until a year before directors were going to hit retirement age and then say, ‘Next year at the annual meeting, so-and-so is going to be rotating off, so we need to replace him or her, and this person needs to have this type of experience, and you’ve got a year to find him or her,’ according to Keith Meyer, vice chair and global head of CEO and board practice at executive search company CTPartners. ‘It was all very straightforward.’

While some boards are still stuck in the old days, many are evaluating potential directors based on what the market demands and what makes the most sense for the company and its stakeholders. ‘It’s a different model,’ says Meyer. ‘We’ve got a world that’s much faster and more dynamic, so companies are thinking about what the big decisions are, and how they’re going to get the best candidates in the chair.’

More and more boards are grappling with the big questions. ‘How do we shuffle our board? What is the right time to make changes? How do you get someone to step aside?’ says Jay Millen, board of directors and CEO practice leader for executive search firm DHR International.

Making changes is a challenge. In addition to board leadership being uncomfortable with the issue, according to PwC’s survey, other impediments include a lack of individual director assessments and ineffective assessment practices, and not having term or age limits.

‘In most cases boards need to be prodded and embarrassed into taking a proactive view,’ notes McGrath. ‘Boards are not moving as fast as the businesses they theoretically oversee.’

Facing the challenge

For sure, ‘refreshing’ the board is a difficult interpersonal challenge. ‘I think being extremely transparent about expectations and the other person’s ability to deliver is key,’ says McGrath. ‘It also helps to have a third-party assessment, potentially a consultant or someone who is not part of the immediate decision-making group, who can create recommendations that can spur constructive dialogue.’

A leading practice for board succession planning includes using a matrix to shape the composition of the board – to identify the skills, expertise, attributes and experience necessary to support the company’s strategic plan over the short and long term. Some identified attributes may apply to all directors, while others will represent a balanced mix among the board as a whole, given a company’s current and future strategy and business, says Rutherford. The development of a matrix provides an opportunity for thoughtful discussion and observation and allows the board to identify any gaps that need to be filled.

Ongoing, robust director and board performance evaluations can create the mechanism for generating strategic board renewal aligned with the company’s goals. ‘Having a third party help facilitate the assessments can depersonalize the process,’ says Rutherford. ‘The evaluation process helps to ensure individual competencies are fully understood, recognized, used and valued.’

Board renewal is a process that has to start somewhere, such as instituting a change in practices by considering staggered board terms in favor of maintaining institutional knowledge, while keeping in mind the best age for mandatory board retirement, says Linda Bollinger, founder of the non-profit organization Boardroom Bound. ‘These challenges speak directly to taking the twin cults of personality and prestige out of the picture and making room for diverse and next-generation board member inclusion.’

The bottom line, says Keller, is that ‘boards may have the talents and skills they need today, but what about tomorrow? Boards must continuously look for candidates. The pace of change is accelerating with the use of technology. Board renewal has to accelerate into the future; the question is whether boards can keep up. You have to wonder whether a member who has been on the board for 10 or 15 years is current enough.’