What do CEO’s need in their boards of directors?

Today, board composition is considered a vital element of company strategy, making the decision about who should be nominated to serve on the board much more deliberate in terms of adding relevant knowledge and experience.

When a vacancy occurs, most commonly after a director’s retirement, boards have a list of criteria for the new member. The list includes precise experiences such as launching or managing a business in Asia, explicit competencies in technology or digital media, and diversity, not only in gender and ethnicity but diversity of thinking.

Board composition becomes increasingly important when companies are undergoing fundamental change, such as a media company forced to reinvent itself as a digital business. In such a case, management is dealing with a business that is changing along with its customers, as well as a transformation in its method of delivering products and services.

Jolted by seismic shifts, management can often get caught up in a scramble, struggling to keep pace with change. This is a time when the board can play an important role, if it has the relevant expertise. In times of such turmoil, company leaders come to understand the value of a board member who has lived through the kind of change the company is experiencing. And, even if it’s not the same industry, having access to a director...
who has experienced rapid change and transformation is enormously helpful.

At the same time, prodded by the changes that directors see in the company’s business, boards are becoming more aware of gaps in their own ranks. What were useful or even ideal skills and experiences for a director a decade ago can quickly become less relevant.

Korn/Ferry International has observed these developments as it conducts board effectiveness assignments. The work begins with interviews with all board members, including a peer review of individual directors, and results in an objective analysis of skills and experience. Not only are the board and the CEO able to see the gaps that exist, but the analysis also provides a road map to acquiring the skills and competencies that the company needs going forward. Getting the directors to commit to acquiring these competencies in their next board member nomination is critical. Through the process, the CEO often can focus less on managing the expectations of the board and more on valued input from his or her directors.

In the case of a major public utility, the new CEO arrived to find that his board lacked experience in working with regulators, environmental groups and public policy organizations. With his board’s agreement, the CEO recruited two new directors with relevant experience, both of whom could be an asset to the leadership team and other board members, particularly with increased regulatory oversight and environmental challenges.

Board composition is also at the heart of shareholder activism. With more tools to achieve their agenda, institutional shareholders are less likely to dump their shares in struggling companies. Activists seek board seats when they see an opportunity to improve the company’s operations through directors who have industry knowledge or management expertise.

“The great challenge for today’s boards in this new era of activism is catering to all the diverse ‘shareholders,’ which includes those with a longer investment horizon like pension funds and mutual funds, as well as those who are seeking quick profits,” wrote Ira Millstein in a recent posting on DealBook. He is the co-chairman of the Millstein Center for Global Markets and Corporate Ownership at Columbia Law School and a senior partner at the law firm Weil, Gotshal & Manges.

Boards no longer operate behind closed doors or in a vacuum. The shareholder advisory vote on executive compensation or “say on pay” has provided a window into board oversight. Directors are mindful that what shareholders view as extravagant compensation can convey a lack of board independence. Directors on the compensation committee have learned that they themselves can become targets for “no” votes in such a situation.

Activism has gone mainstream as say on pay has come to legitimize shareholder scrutiny of directors’ competency. But it doesn’t stop with pay packages. New disclosure rules allow shareholders to examine what the board counts as the competencies of its individual members. Is it clear that the skills and experiences listed will help to advance the strategy of the company? And increasingly, shareholders are asking to see a more diverse board, one that reflects the company’s customers.

Investor Bill Ackman set an example for other activists to follow in his proxy battle for control of Canadian Pacific, an underperforming company whose CEO delivered a negative 18 percent return over a five-year period while topping the charts in compensation. Ackman bought 14 percent of CP’s shares in late 2011 and by May 2012, Chairman John Cleghorn, CEO Fred Green and four other board members were announcing that they would resign their positions and not stand for board re-election on the eve of the railroad’s annual shareholder meeting.

By engaging with institutional investors and proxy advisers, Ackman shared his vision for improving the railroad’s long-term performance with a dynamic new CEO and a board of directors with industry expertise. He won over key institutional investors – the Ontario Teachers’ Pension Plan with its $100 million investment and the Canadian Pension Plan Investment Board.

J O E G R I E S E D I E C K is vice chairman and managing director, board and CEO services. His focus at Korn/Ferry is primarily on engagements for CEO and board director searches across multiple industries, as well as working with boards of directors on CEO succession planning and other related senior talent management practices. K A R E N K A N E, former board secretary for the Federal Reserve Bank of Chicago, is the principal of Board Performance Strategists, a consultancy to help CEOs and boards win long-term shareholder support.
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Proxy advisory services Glass Lewis and ISS supported Ackman, resulting in an overwhelming number of investors who were willing to upset the status quo of one of Canada’s largest and best-known businesses. Cleghorn and Canadian Pacific had been “Ackman-ed,” the new business term for the fate that befalls an unresponsive and ineffective board.

The Ackman lesson is not lost on CEO’s. They are looking at their own boards and the boards of their competitors as well. CEO’s who see competitors adding technological know-how and global experience to their boards are likely to be more vocal about recruiting directors with strategic capabilities.

At the same time, as legacy directors age, their skills may become less relevant. Even in the face of greater scrutiny, most directors like their jobs and believe that they should continue until retirement. Some have likened board service to a tenured faculty position. In 2012, the number of new director positions in the S&P 500 fell to 291, a decrease of 12 percent in five years and a 27 percent drop from a decade ago.

Meanwhile, shareholders are paying closer attention to the diversity of boards as it relates to a company’s strategy, along with the relevance of each director’s experience on the board. Diversity, technology and global involvement are the game changers.

Creating a winning board demands more than simply recruiting directors with the desired skills and backgrounds. Diversity in the boardroom is not simply the inclusion of women and racially or ethnically different individuals. It is diversity of thinking and experience.

Competencies are key. How could a board without digital and social media business experience fully grasp the need for strategies that promote the product through direct engagement with the consumer, shareholders could ask. As Stephen Davis, associate director and senior fellow at Harvard Law School’s Programs on Corporate Governance and Institutional Investors, says “If you’re not on social media, you can’t appreciate its power as both an asset and a liability. I’m not saying every director should have that experience, but you need one or two or you won’t be asking the right questions.”

The business case for diversity at the board level is compelling.

A study by Wellesley Center for Women found that diversity in gender, ethnicity and age is critical for adding women to boards. Results validated a performance-based ratio that some years ago documented that the number of women on a board makes a difference. While a lone woman can and often does make substantial contributions, and two women are generally more powerful than one, increasing the number of women to three or more enhances the likelihood that women’s voices and ideas are heard and that boardroom dynamics change substantially.

Additionally, studies by Catalyst have validated a performance-based rationale for adding women to boards. Results have demonstrated that companies with women board members outperform companies with only male directors. Most boards have received the message from their shareholders that they need to increase the number of women directors.

Last year Jill Smith was elected to the board of Endo Health Solutions, a company that prides itself on delivering “solutions for 21st century health care.” Smith brings technology and international experience to the board. Having begun her career with technology companies in London before becoming chairman and CEO of DigitalGlobe, the satellite company, Smith oversaw DigitalGlobe’s stellar growth and transition to a publicly held company. She also became the second female on the board, adding to the board’s diversity.

By recruiting Gina Bianchini, founder and CEO of Mighty Software and former CEO of Ning, Scripps Network Interactive expanded its board’s critical capabilities. A pioneer in social networking, she helps clients use social software in a way that connects them online and off. Bianchini brings critical expertise to the board while raising the number of women on the board to three.

A company that has long been focused on technology and diversity, Wal-Mart recruited another talented female vice president of Google to its board in 2012, increasing the number of female board members to four. Months later, Marissa Mayer was named CEO of Yahoo.

It’s fair to say that boards are looking around the table and realizing that they may not have the relevant expertise to help the company deliver on its strategy. The new generation of directors will provide general management and industry expertise along with financial business knowledge. Boards are defining their specific needs in director candidates who provide insights into new customers, technology leadership – particularly as it pertains to channels and transformation – as well as international market experience and diversity in gender, ethnicity and age.

As directors continue their board service in this increasingly transparent and demanding world, boards understand that they sometimes need additional help in overseeing CEO and board suc-
Evidence abounds that a group of diverse individuals is likely to make better decisions, making boardroom diversity a key shareholder concern. The Securities and Exchange Commission affirmed this when it updated its proxy disclosure to require boards to include their consideration of diversity. Increasingly, boards are looking critically at themselves and developing strategies to expand the breadth of backgrounds, experiences and perspectives of their directors. “Boards recognize that a shift towards more diversity and building an inclusive culture are essential if they are to successfully navigate the economic, societal and demographic changes shaping the global marketplace,” said Oris Stuart, CEO and managing partner of Global Novations, a global provider of diversity, inclusion and leadership development coaching. The firm was recently acquired by Korn/Ferry International.

“While this focus is not entirely new, the intensity and deliberate speed of the efforts has significantly increased,” said Stuart. “This is partly due to the recognition that past strategies have yielded very little change in board makeup. The increased focus also reflects the critical nature of this topic to the board’s and, in turn, the organization’s overall performance.”

Strategies for building diverse and inclusive boards vary by organization. Several approaches, however, have been identified as best practices. “Our clients are pursuing several means towards increasing the diversity and inclusiveness of their boards. Some of these include establishing formal targets for nominating slates, expanding their reach for new candidates, building or reinforcing tenure limits, proactively pipelining, and creating rigorous onboarding processes for new directors,” said Stuart.

Diversity in the boardroom, defined simply as the inclusion of women and racially or ethnically different individuals, is just one aspect of board composition, which also involves having the right skills and experiences. Many boards now develop a matrix of skills that members bring to the board along with a gap analysis of what the board needs in its directors going forward.

“Pipelining,” or positioning executives within the organization for board service at other companies, is a growing practice. “There is no better proving ground for an executive leader than becoming a director for another company,” said Stuart. Not only is the executive able to bring his or her skills and experiences to the board, but he or she learns firsthand about serving in a strategic role and gains experience in governance in the process.

Another aspect of pipelining is identifying diverse candidates proactively and making board introductions before the position is open. This practice helps the board to better understand the value and availability of a broader range of talent in the marketplace.

“As diversity increases and boards become more complex, we also work with boards to build a culture of performance and collaboration,” said Stuart. “Over the past 20 years, we have become experts in onboarding executives to a new environment. This experience allows us to help our clients form a more inclusive culture and create the kinds of teaming relationships that enable directors to work together more effectively.”

The rising importance of board diversity coincides with the increasing complexity and globalization of business. Global Novations is a natural extension of Korn/Ferry’s capabilities in guiding boards to higher levels of performance.