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# Adapting Board Composition for a Changing World



The COVID-19 crisis has increased the demand for board insight, oversight, and advice, while boards attempt to adapt to new ways of working, new tools, and new structures. Many have stepped up as a powerful sounding board for stressed CEOs. Other boards struggle, not contributing as needed or causing unnecessary distractions.

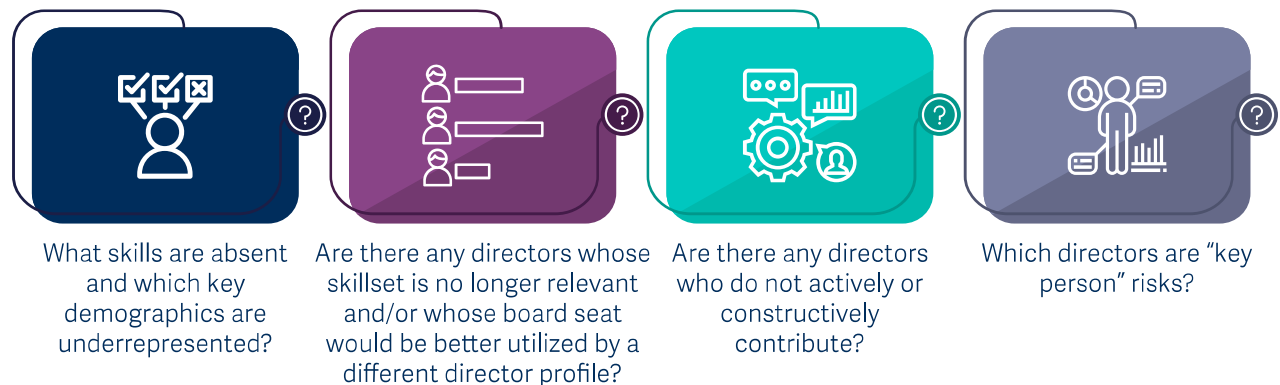
**Despite the fact that most boards have done well, over the last quarter we have seen:**

- Directors whose skills and experiences no longer match the circumstances of the company as strategies are rethought and companies pivot to new products, services, and operating models
- Overboarded directors who could not be counted on to show up for multiple crisis meetings
- Sitting CEO and CFO directors who must necessarily pay attention to their own business first
- Directors with too much time on their hands who overstepped into operations, wasting management's limited time and resources
- Technology-averse directors who could not manage to join a Zoom meeting
- Older directors who are no longer sure they want to go through a crisis like this again
- Boards who simply do not have enough directors to staff ad hoc crisis-related committees

Boards and management teams are starting to consider how to reshape the board to cope with the current crisis, a potential second wave, and whatever the new normal looks in the years ahead. Will the board need to add restructuring/turnaround experience, more current or retired CEOs with general management experience, digital expertise or diversify itself to avoid dependence on directors in the most at-risk demographic groups (i.e., over 70)? Is there a director succession plan in place, particularly for key board leaders? Institutional investors who are looking at the board's performance during the crisis and in the coming years will continue to push boards to improve composition and effectiveness, with an increasing focus on racial and ethnic diversity.

The crisis has also illuminated the leadership abilities of the management team and their diversity (or lack thereof) and raised important questions about the executive succession plan. The same is true for board succession. Future director searches will require a candid analysis of the board's current composition against changing company strategy, identifying future needs as they become clearer and developing a more thoughtful approach to board recruitment.

Under the current circumstances, boards must ask the tough questions:



To answer those tough questions, enhance risk management, and support governance best practices, boards can start with a board composition analysis, a strategic planning process that consists of four primary activities led by the Nominating and Governance Committee (NomCo):



#### **UNDERSTAND THE LIKELY EMERGING STRATEGY:**

1 The first step is for the NomCo to leverage its understanding of the company's emerging strategy and related organizational changes, as they will play out over the next few years. This will provide the context for the board composition analysis. If that path is not yet clear enough, the committee can focus on company purpose.



#### **AGREE ON THE SKILLS AND EXPERIENCES REQUIRED:**

2 If the committee has a sense of the direction of travel for the company, it will be easier to decide who ought to be on the bus (to invert Jim Collins' famous edict<sup>1</sup>). Thus the second phase focuses on developing a clear and agreed-upon set of definitions for the key skills and experiences (including diversity) that will be needed at the board level and for the committee to take a hardheaded look at each director's skills and experiences against those definitions.



#### **CREATE CONSENSUS ON FUTURE PLANS:**

3 The third phase is to work with each director and review the matrix with them. It is important that everyone feels the process has been fair and transparent. The committee also needs to explicitly ask each director about their personal plans vis-à-vis the board (all other factors being equal). An accurate forecast of when vacancies may occur is essential, though the committee may also need to make tough decisions to create vacancies in order to refresh the board.



#### **CONSIDER WHAT TO DISCLOSE:**

4 Investors are seeking more information in an easily digestible format to enable them to understand how board composition links to the company's strategy. Having completed the prior steps, board leaders and the legal team can determine what can be disclosed to investors about the process, current board composition and decisions about future recruiting.

## **The Wrong Way to Do the Right Thing**

As beneficial as board succession planning can be, there are numerous ways that it can be done badly to the ultimate detriment of the board, the company and its shareholders. We have seen four common errors that derail the work:



#### **PUTTING STRATEGY AND PURPOSE SECOND:**

1 We often see boards undertake these efforts without explicitly connecting them to the overall strategy or purpose of the company.



#### **IGNORING THE COMPETITION:**

2 Boards often fail to benchmark themselves against their peer group, yet when analyzing corporate governance practices, investors often look at entire sectors at a time.



#### **ASSUMING IT'S ALL ABOUT JOINERS, NOT LEAVERS:**

3 Movement of directors is a natural occurrence—whether due to age or tenure limits, overboarding, or individual director desires and life changes. We have seen too many occasions when these changes were known ahead of time by directors but not shared with the NomCo.



#### **FORGETTING ABOUT BOARD AND COMMITTEE LEADERSHIP AND MEMBER ROTATION:**

4 While few boards have policies to limit the tenure of the board leader (non-executive chair or lead independent director) and other key roles or committee memberships, it is important to understand the impact of retirements and new joiners on the composition of committees. The leadership of committees and the board itself should be part of the plan.

<sup>1</sup> "The executives who ignited the transformations from good to great did not first figure out where to drive the bus and then get people to take it there. No, they first got the right people on the bus (and the wrong people off the bus) and then figured out where to drive it." Jim Collins. *Good to Great: Why Some Companies Make the Leap... and Others Don't*. New York: HarperCollins, 2001.

Once the board begins the process of undertaking a composition analysis, it is important that it is an open, inclusive process involving every single director. This can't simply be managed by the general counsel or another executive from afar. Everyone has to have buy-in to the process and analysis.

However, boards can't avoid hard conversations during this process. Some of today's directors won't have an obvious role on tomorrow's board, and others may believe they have qualifications or relevance that they don't truly hold. The board leader or NomCo chair needs to be willing to have an open, honest, and direct conversation with each board member during this process, including a willingness to help some directors find their way off the board.

While the board has to own the process and the results, using a third-party advisor can help deal with some of the challenges involved. One benefit is that an external advisor can help ensure there is the required objectivity and rigor in the process.

## The Benefits of Action

A rigorous board composition analysis creates value in numerous ways:



1

### IT ENABLES THE BOARD TO SET ITSELF UP FOR LONGER-TERM SUCCESS:

A well-run board succession effort prevents a transactional approach to director recruitment. Similarly, it enables thoughtful board rotation, including for committee chairs and the board leader, and therefore could be used to improve diversity efforts in board leadership roles.



2

### IT GIVES THE BOARD OR NOMCO CHAIR A NEUTRAL, DATA-BASED TOOL FOR ADDRESSING INDIVIDUAL CONTRIBUTIONS TO THE BOARD:

It's difficult for any chair to sit down and address issues of personal contribution with a fellow director, but a board composition analysis creates tools and opportunity to have a more neutral, fact-based discussion about skills and qualifications. Likewise, it can provide a foundation for talking about director retirement, leadership changes, and committee rotation—all things a healthy, well-performing board ought to address.



3

### IT CAN BE COMMUNICATED TO OUTSIDE STAKEHOLDERS:

A rigorous board composition analysis is further evidence that a board is taking its responsibilities seriously, is thinking about the future direction of the company, and is prepared to help steward the organization over the long term. The board, if it so chooses, can disclose the analysis to outside investors.

Thoughtful succession planning is critical to an effective and high-performing board. Although it must be championed by the independent board leadership, an outside advisor can help or even lead the effort. But it is ultimately up to the entire board to thoughtfully engage in the process and be open to the conversations that follow.

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