AN OUTPOURING OF DIRECTORS ANSWERED OUR CALL FOR OPINIONS IN THE 11TH YEAR OF CORPORATE BOARD MEMBER'S FLAGSHIP STUDY. READ ON FOR FULL COVERAGE OF THEIR VIEWS ON THEIR TOP CONCERNS AND STRATEGIES FOR 2014.
What kind of board does your company need to maintain a competitive edge? Industry and leadership experience are obviously important factors and most boards have added a financial expert thanks to Sarbanes-Oxley, but does your board have IT expertise? Social media savvy? How about an international perspective?

Given the meteoric rise in IT risk, it is likely your board either already has a director who is well versed in information technology and data security or is looking for one to help it better understand the company’s IT risk profile. The same is true for the fast-growing realm of social media; its increased use as a competitive strategy in recent years has brought correspondingly greater risks. And if your company is contemplating expansion outside of the United States, bringing in a board member with international experience is a must. At the same time, more attention must be paid to the tricky arena of anticorruption and FCPA compliance, with its minefield of risk.

The results of the 2014 Corporate Board Member/Spencer Stuart What Directors Think survey, a long-running annual study based on the input of public company directors nationwide, reveal directors’ views on rejuvenating the board, risk oversight, say on pay, and more. In many areas, this year’s findings align with more than a decade of What Directors Think results and demonstrate that CEO succession and the desire for more time for strategic planning continue to be chief challenges for U.S. public company boards.

In addition to the core areas of study, this year we posed a number of questions around board structure, turnover, and guidelines to better understand the methods and processes boards are employing to maintain their vibrancy and effectiveness. Interestingly, quite a few directors wrote in to comment that these latter issues, while topical, should never become a distraction from their primary responsibility of improving the bottom line.

For example, one director noted that while surveys typically ask about say on pay and regulatory issues, the board’s focus should be squarely on enhancing shareholder value: “Shareholders want us to make money for them. … We work for those who invest in our companies to make a profit.” Another offered a similar comment, saying, “A board’s obligation is to further and enhance a company’s revenue growth, profit potential, and shareholder benefit” rather than to be overly concerned with political correctness. This year’s results support the fact that directors’ commitment to shareholder interests remains paramount, but Stephen G. Kasnet, a survey respondent and chairman of Rubicon Ltd., maintains boards can find common ground with some of the so-called softer issues and those that have a direct line to profitability: “A well-informed board can and does establish goals and structures that meet the shareholders’ and business’s needs.”

To provide context to the issues that surround corporate governance at the start of 2014, we have organized survey data into five categories: board composition and effectiveness, leadership challenges, executive compensation, risk management, and strategic planning. While compensation and succession are long-running themes, the results show there are new twists on risk oversight that undoubtedly reflect the current corporate environment, both technologically and globally.

**ASSESSING BOARD COMPOSITION**

For any given company, there must be both management and a governing body that are up to the task of meeting current challenges. And while many of the requisite skills are the same year after
year, corporate challenges continue to evolve that require new blood and fresh approaches.

While the concept of “refreshment” is more readily applied to employees and management, there’s a growing trend among investors and academics to apply it to boards as well. Shareholders want to ensure that the boards of the companies in which they own stock are capable of handling the leadership and governance demands of the current marketplace and that the highest standards of independence are being met. This viewpoint reflects the belief that today’s corporate boards are one step further from the days when boards were often formed under the auspices of longstanding friendships or business favors—and stayed that way.

Today’s board members are well aware they need to stay sharp. As John Bagalay, one of our respondents and an executive in residence at EuroUS Ventures, notes, “Failure to establish an orderly method of changing board composition creates two problems: one diplomatic and the other leadership refreshment.” Two-thirds of directors we surveyed agree, finding the need to periodically refresh the board with new blood as either important (51%) or critically important (16%), with another 26% saying that refreshing the board is at least somewhat important (Figure 1). Bagalay adds, “All companies need board members who come on without a predisposition to accept the way things are.”

And the time has never been more appropriate for a jaundiced look at board composition. According to What Directors Think survey partner Spencer Stuart, among S&P 500 boards, retirement ages are being pushed back, and as a result, board members are becoming older and more entrenched. “While it sometimes makes sense for boards to ask experienced directors to remain on the board longer, they must also ensure they have the diversity of skill sets that are important in today’s business world to define a forward-looking strategy and vision and manage key risks,” says Julie Hembrock Daum, who leads the Spencer Stuart North American Board Practice.

Yet, one irony today is that adding younger board members to the ranks inadvertently means these new directors may one day end up with longer-than-average tenures. Along those lines, we asked directors whether it would create a problem for a board member to serve as much as 30 years on one board. Respondents were split on this point, with 53% saying yes; 47% no. As one director noted, “I generally favor age limits, but [Warren] Buffett is causing me to rethink the issue. Who wouldn’t want Buffett at 80-plus?” Another pointed out that proponents for age limits “seem to focus on the negative side of longevity but give little or no credence to the wisdom gained only through years of experience.”

Jim Hunt, a survey respondent and retired Walt Disney World executive who sits on several boards including Brown & Brown Insurance, says, “A robust, specific board evaluation … of each board member, coupled with individual discussions with each member by the chairman/lead director, should provide for a company’s board to be self-reflective and allow for change as needed.” And in his mind, this type of well-executed evaluation negates the need for external regulatory pressure to manage board performance. “The fact that a great many boards are up for reelection annually allows for shareholders to give due consideration to board performance,” he states, and thus evaluations can be handled without regulatory intervention.

Most boards have formal policies regarding ongoing board service and tenure. Just over half (53%) of directors reported that their boards employ a mandatory retirement age. In addition, 39% said their boards require a
mandatory resignation submission in the event of a personal reputational event, such as a bankruptcy or arrest, and 28% require a mandatory resignation if a director fails to garner a majority vote. However, fully half of those surveyed said the latter is not required nor needed, which may indicate a preference by directors to evaluate each case individually rather than under blanket guidelines.

In addition to examining the methods boards are using to refresh their ranks, another important function is for boards to undertake a healthy self-evaluation to ensure all sitting members are contributing something unique and relevant to the whole. This is often an important step when there is a vacancy on the board. Dovetailing with this idea, the survey asked directors which attributes would be most important in selecting their board’s next new member. Not surprisingly, financial and industry expertise were the top two choices, followed by CEO experience, knowledge of information technology, and global expertise. Close behind was the relatively new demand for directors with marketing and digital/social media experience.

Industry experience is often viewed as a compelling factor for selecting a board member, especially in terms of how a candidate could contribute to the competitive growth and strategy of the company. Tim Gentz, a survey respondent and chairman of Speed Commerce Inc., says to make his board stronger, “We need to enhance our industry knowledge both via education and by recruiting candidate(s) with industry experience, as we have recently changed our strategic direction.”

With regard to leadership experience, the survey found a difference of opinion about the upside of having active CEOs serving on boards. One director said there is a need for more CEOs or COOs who are willing to sit on boards, explaining, “We now have too many professional board members who are getting education boxes checked through the NACD, etc., who don’t have the experience of actually running an organization. They tend to be good on process and weak on leadership.” But another director complained that “board members who are also CEOs and sit on multiple boards are cheating everyone—[they don’t have] enough time to do any of it right.”

“Active CEOs bring a wealth of relevant current business experience to the board,” says Daum, “which is why they are frequently sought by boards looking to recruit a new director. They also tend to relate well to the company CEO and are well-equipped to build a strong working relationship with him/her,” she adds. “But boards will want to be cognizant of the tradeoffs in adding a sitting CEO to their boardroom, among those, potentially less time to devote to company business in between meetings or when extra time is required—in a crisis, for example. Boards also will want to have a candid discussion about whether they are looking for a marquee name or someone who will actively contribute to the dialogue and deliver value,” she explains.

Daum says the 2013 Spencer Stuart Board Index revealed that 23% of new directors were retired CEOs, COOs, chairmen, presidents, and vice chairmen, compared with just 16% in 2012. And, for the first time, fewer active CEOs than retired CEOs joined S&P 500 boards, 77 versus 79, “suggesting that more boards are comfortable that retired CEOs can make a similar contribution as sitting CEOs—who are more reticent these days to sit on incremental outside boards,” she notes.

One area that Corporate Board Member has been actively tracking for the past several years involves initiatives to promote board diversity. Thought by many to have benefits above and beyond a perception of political correctness, board diversity has gained momentum in countries that have put their regulatory muscle behind such initiatives. Such regulations, however, have not gained a foothold in the United States, nor do most directors expect them to. Nearly 60% believe there will be no formal actions in the U.S. in the next three years related to board diversity, though 38% believe we will see increased pressure on this front by investor activists.

As one director noted, progress toward more diverse boardrooms is likely to occur, but it will come about by more organic means. “Diversity cannot be achieved by mandatory
selection of less experienced members; it has to come about naturally through societal changes. As more and more diversity enters the job market, the pool of directors will allow for diversity.”

These views are telling in that directors themselves are a key component in how their future boards are shaped. Nearly two-thirds (63%) of those surveyed, for example, said individual board member recommendations are the most successful source of new board members, followed by the use of search firms (22%).

Ironically, despite the earlier finding noting that two-thirds of directors believe it’s important to refresh the board, they rated themselves least effective in terms of the nominating/governance committee’s process to effectively encourage board turnover and to create a board that has a balance of needed skills and diversity. Other relative weaknesses noted by respondents include the full board’s ability to complete a management succession plan and to monitor the organizational risk management plan to mitigate exposure.

It’s worth noting that two of the bottom four results in this category are related to board composition and turnover challenges, indicating many directors are attuned to the fact that these important areas need more attention in the future.

“Spencer Stuart’s research shows the number of new board appointees fell by 23% in the period between 2008 and 2012. While there was a 16% uptick in the number of new independent directors elected to S&P 500 boards during the 2013 proxy year (339 directors), boards continue to wrestle with the question of how to promote ongoing board renewal,” Daum says. “In our experience, making board composition and performance an annual topic of board discussion is a good approach to ensuring the board has the right expertise and skills as the economic and competitive landscape changes.”

In analyzing the methods used by boards to encourage healthy turnover, 85% of directors surveyed said board assessment/evaluation is an effective tool to encourage board refreshing. Boards use annual board evaluations to assess the effectiveness of the board as a whole as well as the contributions of individual directors, which can identify directors who are underperforming or whose skills no longer represent a good fit with the strategic direction of the business.

FORTY-NINE percent cited the use of an age ceiling and 24% chose term limits as a means to bring on new members (Figure 2).

“Whatever the tool, boards should ensure they are having a regular dialogue about whether the expertise and diversity of perspective around the table reflects the strategic vision for the organization,” says Daum.

Finally, in the area of board performance and effectiveness, we surveyed directors’ views on director education. Nearly three-fourths of those surveyed (73%) said they receive reimbursement for attending an educational program they anticipate will make them a more effective director.

CHOOSING COMPANY LEADERS

Since this study’s inception in 2002, succession planning has continually topped the list of challenges for boards, and this year was no exception: 10% of respondents said they were “poor” at this responsibility and another 26% said they were “adequate”—much lower than other dimensions measured. Why, year after year, is this so, we wondered? According to director Jim Hunt, boards continue to grapple with CEO succession planning because they sincerely want to “get it right.”

Interestingly, it’s long-term succession that they lack confidence in—not short term. Fully 81% indicated that the company’s succession plan would proceed without a hitch in the event their CEO was immediately unable to perform his or her duties. While these findings might seem at odds, they more likely reflect the distinction between an emergency plan and a successful, long-term succession plan. As Rubicon’s Kasnet explains, “As a young company, we foresee little need for a directional change but are prepared for the potential of an abrupt change.”

Speed Commerce’s Gentz agrees. “I believe boards take this issue on with great vigor when they are faced with an imminent CEO change (planned or otherwise). However, when not faced with that urgency,” he explains, “boards tend to ‘theoretically’ deal with the issue, knowing it is important but not wanting to delve into it in detail until necessary. Oftentimes this is to avoid creating concern for the incumbent.”

The survey also sought to find out
more about boards’ ongoing processes to plan for succession within the ranks of rising senior management. Almost 60% indicated their board has some type of formal process to assess internal candidates, leaving nearly four in 10 that do not. In another finding, 68% indicated their company’s method for benchmarking candidates against best-in-class talent is at least somewhat effective, nearly 20% admitted their efforts are not at all effective, and another 14% were unsure.

On an encouraging note, nearly four-fifths of those surveyed said their board reviews the company’s CEO succession plan at least once a year, and another 14% said they do so whenever the need arises.

“By definition, internal candidates are not proven CEOs. To gain insights into whether a candidate is capable of moving into the role, boards need to embrace an assessment process that is fact based, rigorous, and forward looking. It’s also important to not lose sight of how an organization’s internal talent compares to the best-in-class talent externally,” Daum explains. “Taking a look at external talent—through research, informal or formal introductions, or a search—can provide important insight when assessing the readiness of potential successors,” she adds. “This process is critical to give the board a good sense of the relative strength of the internal candidates, as measured against the outside talent pool that would likely be considered for the role.”

Another tough leadership decision boards have to face is whether to split the chairman/CEO role, an issue that was elevated following the financial crisis of 2008. In light of increasing investor pressure, it’s not surprising that 69% agree or strongly agree that splitting these roles results in more favorable proxy advisory recommendations; likewise, 64% agree or strongly agree that doing so offers more independence of thought within board discussions, and 60% affirm that it establishes more effective CEO evaluations.

However, external forces to persuade boards to split the roles are often met with just as many compelling internal reasons to combine them. In the end, boards need to feel comfortable they are doing the right thing for the company—and for the right reasons. Director John Bagalay, the EuroUS Ventures executive, says that in past CEO searches in which he has been engaged, many CEO candidates have told him they would not take the job unless they were also made chairman. “I have never acceded to that request. The insistence on having both positions is a clear indication that the candidate doesn’t want an ‘intrusive’ board. The separation of the two positions is unwise only if it leads to board micromanagement.” Bagalay believes that separation is essential in order to establish that the board has the right and responsibility to be certain that the company’s business strategy is given a tough and challenging review.

Yet another thorny issue related to board leadership emerges when a CEO steps down and is subsequently offered the chairman’s seat. Whether such appointments stem from personal board loyalty or a desire for continuity, the situation is far from ideal, governance experts say, because the perception of influence from a past CEO is usually too much to overcome. When we asked respondents if, as a hypothetical incoming CEO they would want the past CEO serving as chairman of the board, 82% resoundingly said no.

The common thread running through these issues involves board independence and effectiveness. While a good relationship must exist between the board and senior management to run a successful company, there must also exist a healthy separation for good decisionmaking at the board level. Kasnet’s company has a separate board chair and CEO, along with a lead director who has fairly broad powers, and he says the system works, but he also says he would be against keeping a past CEO on the board if it became a disincentive for an incoming CEO. Hunt adds that while he has observed situations where a new CEO could and would benefit from the departing CEO either remaining in or stepping into the chairman role, he believes such matters are situational and require each board to undergo a considered review to deliver the best outcome for shareholders.
WHAT WOULD IMPROVE YOUR BOARD’S ABILITY TO OVERSEE RISK?

44%  
Better understanding of how to oversee risk

39%  
A separate risk committee

33%  
More time to digest reports

29%  
More detail in reports

11%  
Replacing one or more board members

7%  
Replacing one or more board members

MANAGING RISK

Of paramount importance year after year is the board’s responsibility to oversee risk across the enterprise. As a demonstration that boards are fulfilling this role appropriately, 87% of those surveyed affirm that new strategic objectives are reviewed by the full board to ensure they align with the company’s risk appetite. But there is no denying the job is an overwhelming one. In terms of what would improve the board’s ability to oversee risk, 44% of directors said getting management reports with more key highlights but fewer details would be helpful, while 29% said more lead time to digest those reports would be appreciated. However, some directors obviously feel overwhelmed and find the process burdensome and a distraction. As one director put it, there is “too much ritual risk management and too little emphasis on generating shareholder value.”

Interestingly, nearly 40% of those surveyed agreed they could do a better job managing risk and improving the board’s ability to oversee risk.
job at risk oversight if they had a better understanding of how to do so (Figure 5).

Hot spots crop up all the time, and even traditional risk areas are often murky. For example, 20% of respondents said they are not confident in directors' understanding of the many facets of IT risk, one of the most elusive new risk areas for companies today.

THINKING STRATEGICALLY

In addition to overseeing compensation and risk and finding the right company leaders, board members must keep profitability and increasing shareholder value in their cross-hairs. Without meeting these goals, all the others hold little value. Therefore the board’s role in shepherding strategic planning for future growth is imperative, particularly in an environment where competitive change happens quickly. Bagalay noted that this is another good reason for refreshing the board: “The danger of strategic direction stagnation dictates the need for orderly and predictable change in board composition.” Another survey respondent agreed, saying, “Our board has put a strong focus on discussing our strategic plan with more regularity. We have a number of board members aging out over the next five years, which will create a nice opportunity to bring in fresh blood and some different skill sets.”

Accordingly, 81% of directors we surveyed chose strategic planning as a top agenda item—the most popular response, followed by M&A opportunities (61%), succession (47%), global business strategy (42%), and IT strategy (38%), (Figure 6). One director who commented on the survey noted, “Boards need more experience from members who have private equity or other similar experience to assist the board in matters of M&A and activism. I believe this is a missing component of board composition.”

“There is no question in my mind that boards have gotten significantly more effective at performing their duties over the last 10 years, even though we still see some repetitive negative trends associated with risk and CEO succession duties,” Kerstetter of Corporate Board Member notes. “More and more, boards are understanding and embracing the need for effective board leadership, which should result in more confidence in boards’ abilities to perform effectively in all areas of governance.” In the end, he continues, overseeing risk and selecting/retaining the right CEO are two of the most fundamental duties a board of directors must administer. “My hope is that we will see that confidence reflected in future director opinion surveys.”

LOOKING AHEAD

In all, directors this year appear to be laser focused on ways they can help their companies grow and prosper in the year ahead and are working to better understand and come to grips with the battery of risk elements that continue to make the job more challenging. In doing so, they are on track to ensure that their boards are operating as effectively as possible and have the requisite skill sets to ask the right questions and stay ahead of the risk curve.

Corporate Board Member would like to thank Spencer Stuart for supporting and sponsoring this important annual research as well as to thank the nearly 600 directors who took the time to respond to our survey and to those who offered additional comments and perspectives to this year’s findings. For a full copy of the results, visit www.boardmember.com/WDT2014.