# SUSTAINING BOARDROOM PERFORMANCE: HOW GREAT BOARDS STAY GREAT

A 2016 NYSE GOVERNANCE SERVICES/RHR SURVEY REPORT

NYSE Governance Services

RHR International

**A JOINT RHR INTERNATIONAL AND NYSE GOVERNANCE SERVICES STUDY CONDUCTED IN 2014** addressed a two-part question: what makes a great board and how does a great board add differential value to the organization it governs? One finding of that study was that great boards must continually refresh and renew themselves to sustain a high level of contribution over time. While renewal doesn't automatically equate to director replacement, shareholders expect boards to contribute sustained value by directing the company to seize opportunities and manage risks. To do so, boards must continually evolve and adapt to the changing environment in which they operate.

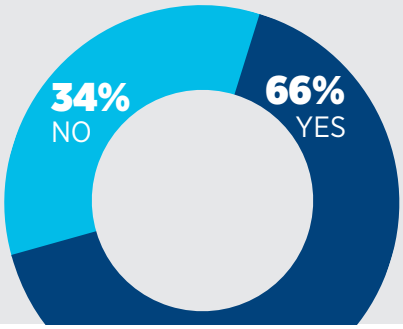
In light of this finding, we took to the field again in June 2016 to survey directors and explore their renewal practices in more depth. The response to our survey was quite strong; in all, 620 directors who collectively offered information on approximately 900 boards returned completed surveys. These directors sit on boards that govern companies ranging from $500 million in annual revenues to the Fortune 100, across all industry sectors. More than half of the respondents have served on boards for more than 10 years and more than half serve on two or more boards, indicating that the directors who responded have significant governance experience. In addition to their responses to survey questions, directors shared their views in hundreds of written comments. Below are the findings organized around four major activities that great boards undertake to ensure they continuously evolve and renew themselves: defining an expected value proposition, conducting periodic performance reviews, ensuring continuing education, and replenishing the board with new skill sets and knowledge areas.

## ① GREAT BOARDS CLARIFY AND CONTINUALLY UPDATE THEIR EXPECTED VALUE CONTRIBUTION.

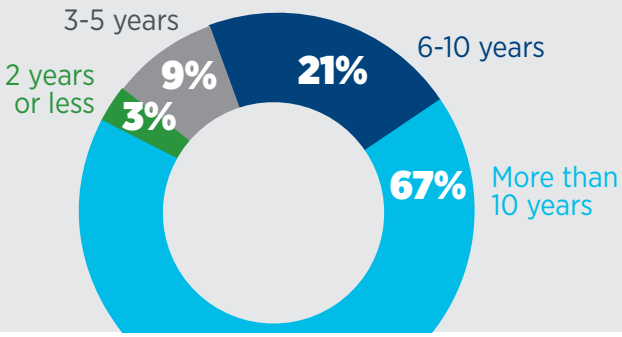
Directors surveyed reveal that over the course of their tenure, two-thirds of the boards they've served made changes to the particular role or value they are expected to contribute to the organization. For those who have served on boards for more than five years, 88% have seen changes in the expected value their board needs to contribute (Figure 1). These findings not only underscore the importance of skill refreshment and periodic assessments of board composition, but also highlight how quickly the landscape is evolving for directors.

FIGURE 1

**BOARDS WHOSE ROLE/VALUE TO THE ORGANIZATION HAS CHANGED OVER TIME**




**TENURE OF DIRECTORS ON BOARDS WHOSE CONTRIBUTION HAS CHANGED OVER TIME**



When looking at individual contributions of directors, 60% say they were given an explicit description of how they would be expected to add value to the board and governance process when they joined. Yet, if boards are trying to deliver against a value proposition, all directors should be given a detailed description of the role they are expected to play in delivering that value proposition. According to this research, that isn't happening 40% of the time.

One director noted the importance of comparing board and company needs, particularly in terms of experience and expertise, with those of current and potential future board members to help assure identified gaps are closed and balance is achieved. Amid a heightened activism environment, great boards keep a close watch on their potential shortcomings and act promptly to strengthen their weaknesses, rather than waiting for shareholders to take notice and agitate to prompt change.

To achieve the best results, the board needs to have a candid and open process to discuss its role and value to the organization. "Once the role and value [of the board] has been agreed upon," commented another director, "the [requisite skills on the board] can be assessed against the needs of the organization." Staying on top of the corporate strategy is key to determining the optimal composition—skills, expertise, competencies, etc.—for the board.

### ② THE BEST BOARDS GATHER AND DELIVER FEEDBACK ABOUT HOW THEY ARE DELIVERING THEIR EXPECTED VALUE.

Periodic evaluations have become a necessity in the boardroom. This is due to several factors, including evolving roles and responsibilities, a duty to generate shareholder value, and the rising threat of activist campaigns for underperforming boards. Directors representing three-quarters (77%) of the boards in our study engage in regular discussions—at least annually—on how to improve their effectiveness and contribution to the organization. The methods used to do so vary, but peer or self-evaluations are by far the most common (Figure 2).

While it is concerning to observe that nearly a tenth of the boards in our study do not conduct annual evaluations of their effectiveness, there is also concern over the fact that of those that do, many say the process is not very effective in generating actionable feedback for improvement (Figure 3). This finding bears asking if the board evaluation process is to blame. Only 25% of boards use outside help, despite expert opinions that an external, independent facilitator can bring a level of objectivity and credibility that enhances the evaluation process.

FIGURE 2
**METHODS OF EVALUATING BOARD EFFECTIVENESS**

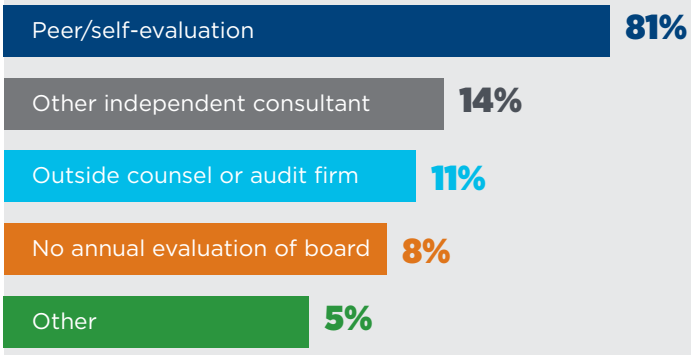
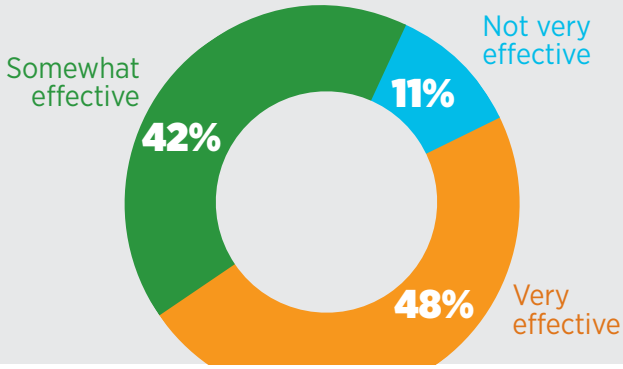



FIGURE 3
**EFFECTIVENESS OF BOARD EVALUATION PROCESS**




Comments offered by survey respondents suggest there are many factors that can undermine the candor and ultimate utility of boards' self-assessment. First, conducting a confidential, objective process is much more likely to yield an impartial analysis and actionable recommendations to improve board effectiveness. Also, a rigorous evaluation process should go beyond the board's overall effectiveness to include the value of each director's individual contribution. Nine out of 10 directors surveyed say they would value receiving feedback on their performance. Yet, only 39% of boards provide it.

"The gap between directors' expressed interest in receiving feedback about how they are contributing and the relative avoidance of this practice reflects the challenges inherent in doing this well," asserts Paul Winum, RHR International's practice leader for board and CEO services. While it can be difficult to tell a director that his or her performance is not up to par, most directors would welcome constructive performance feedback if delivered well. "Board members want to contribute value as they serve, and useful feedback helps them make adjustments throughout their service," Winum adds.

### ③ THE BEST BOARDS CONTINUE TO EDUCATE THEMSELVES THROUGH FORMAL AND INFORMAL MEANS.

Continuing education is increasingly important given the ever-changing industry, regulatory, and technology landscape in which companies operate. Yet, while respondents admit feeling a significant amount of peer pressure to be well read and current on important business and governance topics, merely a quarter (27%) of the boards in our survey have mandatory continuing education requirements (Figure 4). "The problem with mandatory continuing education," opined one director, "is that it is too easy to have a 'tick the box' approach that doesn't add real value. Directors are expected to stay on top of developments in corporate and board governance and to be quite conversant on developments in the industries in which the company competes. Directors who don't remain current are among those encouraged to seek other opportunities."

Outside conferences and internal presentations appear to be the two most popular education approaches. "Individual CE is good, but a shared CE experience also has value," notes one director, who says presentations to the full board by outside experts can be a productive way to discuss topical issues and acquire valuable knowledge.

"The continuing education of board directors needs to be customized to the specific areas of expertise that the board must possess to do its job well, as opposed to a completely self-directed education model," observes Winum. While general education on governance is valuable, directors need to be up to speed on industry- and domain-specific knowledge relevant to their company strategy.

FIGURE 4
**BOARDS WITH MANDATORY CONTINUING EDUCATION PROGRAMS**

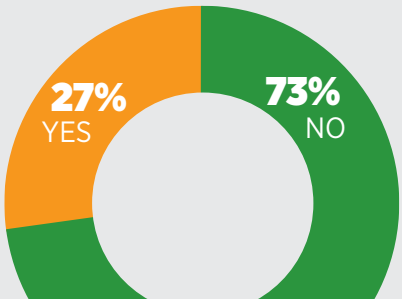
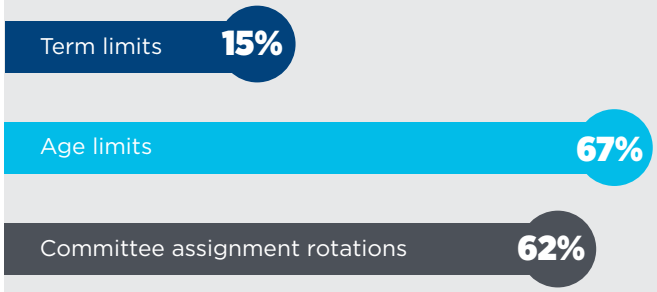



FIGURE 5
**BOARD CHARACTERISTICS**




### ④ GREAT BOARDS RETIRE AND REPLACE UNDERPERFORMING DIRECTORS.

Almost all (99%) directors who responded say they would want to know if their colleagues thought it was time for them to retire from the board, and a third acknowledge there are currently directors on their boards who should be replaced so the board can be replenished with new skills and expertise. Clearly, there is some replacement work to be done, but it's important to note that effective onboarding is critical to helping new directors contribute early in their tenure, as new members can be counterproductive to a well-functioning board when they have trouble finding their footing. Ultimately, all board members need to stay on top of innovation and a fast-changing global environment if they don't want to be replaced, and effective board and committee chairs need to help them do that.

"We regularly review director skills and the needs of our board," remarks one director. "If a director's skills are lacking, we discuss it with the director and plan for a smooth transition to a director with skills we believe would be more effective."

The challenge, however, resides in the fact that the majority (59%) of directors say it can be "very" or "extremely" difficult to exit a director without formal age or term limits. Two-thirds of the boards in our study carry age limits, although many directors insist age should not be the sole determinant that forces the retirement of otherwise highly qualified individuals who are still committed to contributing value to the board (Figure 5). The experience that comes with tenure can indeed be an invaluable asset to a board.

"Companies need to retain the talent that makes them successful," commented one director. "Requiring companies to replace directors after some period of time will result in the loss of that talent and drag down the results."

Directors feel similarly about the need for diversity. Three-quarters (73%) of the boards in our study make special efforts to ensure there is appropriate diversity but "while ethnic and gender diversity are considerations reviewed by the board," noted one director, "we also focus on a diversity of professional backgrounds and skill sets, as well as industry and international experience."

"[Our] priority is ensuring a potential director is fully qualified to serve our shareholders and fills an area of need in terms of skills and experience," added another director. "The diversity question too often is overly simplified to mean race and gender when, in reality, diversity also goes to skills, experience, geography, and several other areas."

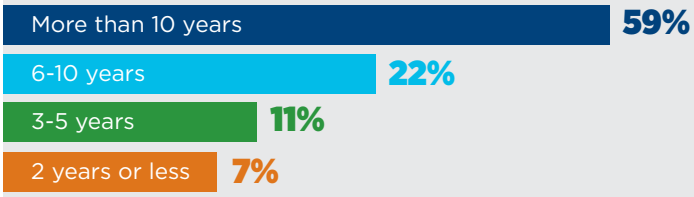
## CONCLUSION

Overall, a constant and open dialogue is key to board effectiveness. Great boards make an effort to remain aligned with their company's strategy as it evolves. Yearly evaluation of where the company is headed in the short and longer term allows boards to define the skill sets they need to get there.

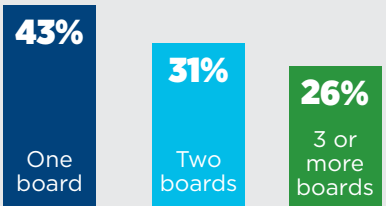
Great boards also ensure that when gaps occur, they are filled promptly to support company growth. Even with age and term limits in place, directors need to ensure that objective, independent, and rigorous evaluations, at both a board and individual level, are conducted annually to identify weaknesses and build on strengths.

Moreover, directors need to remember that their role is in providing the oversight needed to ensure the company is constantly adding value for shareholders. To do so, boards need a well-defined and regularly updated value proposition in which the expected contribution of the board and each member is clearly laid out. It is only with an explicit description of their role that boards and their directors will be in a position to gauge their work, make continuous improvements, and deliver optimal performance.

### SURVEY DEMOGRAPHICS BY TENURE




### BY NUMBER OF BOARDS





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