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BOARD COMPOSITION

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Board composition is one of the keys to good governance. Getting the right people around the board table does not guarantee the company will be effectively governed, but not doing so guarantees that it won't be, no matter how good the policies and processes you put in place.

Unfortunately, there is no standard template to help you. Just as the needs and challenges of every company are unique, so they are for boards. However, while boards must be bespoke, there are certain factors that all companies should consider when deciding on their board structure and balance.

The starting point must be the company's strategy, business model, and operations. The board clearly needs to be capable of understanding them if it is to provide effective oversight, but if it is to provide leadership, not just oversight, then it needs to have the ability to guide their development as well. Ideally, the board will have skills, experience, and perspectives that will enhance those of management.

Even companies with a relatively simple business model may struggle to find room for all the attributes they would ideally want the board to have. Prioritisation and trade-offs will be required. The rest of this chapter highlights some of the choices that boards will need to make.

Board size

The size of a company's board tends to be determined by its size, sector and the complexity of its operations, and the issues with which the board needs to deal. In large, listed companies, boards will typically have between nine and eleven members – or even more in regulated sectors like financial services – while the boards of private and smaller listed companies will typically have fewer.

Conventional wisdom is that big boards are bad. They are harder to chair, making discussion and decision-making more difficult; cliques can form, splintering the unity of the board; and there is a greater risk of some directors losing interest and becoming passengers, not participants.

While these problems are less prominent on smaller boards, they bring challenges of their own. The most obvious is finding a small number of individuals who can collectively provide all the skills and experience the board and company require, although this difficulty can be mitigated, for example, by bringing in advisers to assist with specific issues.

Each company needs to make a judgement as to how many board members it needs. Ideally, that number should be the minimum required to ensure the board has the capacity to carry out its responsibilities fully and the range of attributes needed for it be effective.

In some cases, that may require a bigger board. Regulatory requirements and public expectations have seen the list of the board's responsibilities lengthen considerably; and while the use of board committees can alleviate pressure on the board's time, the more committees there are, the more board members are needed to run them.

Expertise and independence

Many boards benefit from the greater objectivity that directors who are independent of the company's management and owners can bring. Their presence can also provide a degree of reassurance to external shareholders, stakeholders, and regulators that the interests of the company will take priority over the interests of management where the two diverge.

It is sometimes argued that too much emphasis has been placed on independence at the expense of relevant expertise, particularly in the listed sector. I do not personally believe that the two are incompatible. Depending

on their size and sector, most companies should be able to find board candidates who are both independent and expert. This may mean looking a bit harder than is sometimes the case, and not limiting your search to the “usual suspects.”

What is often more difficult is prioritising one type of expertise over the other. Some boards consider it important to have non-executive directors (NEDs) with direct sectoral experience. This can be invaluable if, for example, the company has a relatively inexperienced management team; but it is arguably less useful if it just replicates the expertise that the company already has, leaving other gaps unplugged.

Many companies use a skills matrix when developing or refreshing the board. These can be a useful starting point as they prompt you to think about the expertise required by the board as a whole or for specific positions (for example, committee chairs) and compare it with what the current board has to offer – informed by the results of the board’s evaluation of its own effectiveness, where one has been undertaken.

Looking ahead at the risks, opportunities, and changes in the operating environment facing the organisation in the next few years, and building these into the matrix can help identify what the board needs if it is to shape these developments rather than simply respond to them.

Executive directors

There are different views on the merits of having executive directors (that is, senior management) on the board.

In some countries, companies will typically have a “two-tier” board structure which formally separates the oversight and management functions, with a top-tier supervisory board that is completely non-executive. In countries where the single or “unitary” board is common, companies will usually have the CEO and perhaps the chief finance officer on the board, but rarely more than two or three executives in total.

One view is that having more executive directors at the board table leads to more effective oversight of senior management, enhances the quality of board discussion by ensuring it is informed by a good understanding of the operational considerations, and creates a shared sense of purpose.

Opposing that, others argue that executives reporting to the CEO are unlikely to be willing to demonstrate the independent judgement expected

of directors when he or she is in the room; and that the larger the executive contingent on the board, the more likely that the atmosphere will become too cosy and the non-executives will be reluctant to challenge them.

There is no right answer, but there may be certain circumstances in which the arguments for having more executive directors are stronger; for example, if the company is operating in multiple sectors or geographical markets, or where the board feels it needs more direct line of sight of functions critical to the organisation's success.

Bringing in outsiders

For some companies, particularly those run by entrepreneurs and families, deciding whether to bring an outsider onto the board can be agonising. Some see it as a threat to their control, others as a betrayal of the company's values.

Smaller companies with no ambition to grow may not need to look outside the family or employees to find the skills and experience that the board requires. For most others, though, there comes a point when the benefit of drawing on a broader pool of talent outweighs their concerns.

Opening the board up need not be, and should not be, at the expense of developing in-house talent, of course. All companies can benefit from investing in senior managers to enable them to be "board ready" when required, for example, by encouraging them to take on non-executive positions elsewhere.

"Fit" versus diversity

When asked what they look for in new board members, you will often hear chairs talk about the importance of being a "good fit." This phrase has different meanings. It can mean "someone who shares our values and will embody the culture we are trying to create," which is clearly highly desirable. But it can also mean "someone who looks and thinks just like the rest of us" or "someone who won't rock the boat."

It is understandable that boards tend to choose members who they believe will be able to work constructively with their colleagues. A board

that is constantly at war with itself cannot be an effective one. An “identikit” board, however, is unlikely to be effective either. There is a huge danger of “groupthink,” of risks and opportunities being missed because everyone comes at an issue from the same direction, with the same assumptions and perspective.

Boards benefit from having a diversity of views and being able to draw on a wide variety of experience. This is more likely to be achieved if the members of the board are diverse as well. In recent years there has rightly been a lot of focus on gender diversity. This is important, but there are other aspects of diversity that boards ought to think about, such as age, ethnicity, and the range of different experiences and expertise already mentioned.

Refreshing the board

The challenges organisations face change over time, and the board will need to change as well. The board that stands still when everything beneath and around it is moving is a board that becomes out of touch. That said, a degree of stability is important to provide clear leadership and to ensure that the corporate memory is not lost. Continual churn can be unsettling not just for the board itself but for those who look to it for direction and support.

All boards can benefit from being refreshed from time to time; the challenge is in judging the appropriate pace. The boards of companies that are growing or entering new markets may benefit from regular turnover, as the skills and experience required change, while those whose business models are at risk of being made obsolete by disruptive competitors may require a radical restructuring. For other, more established, companies it may be that occasional fine-tuning is all that is required.

Making this judgement comes back again to an understanding of the organisation’s current and future opportunities and risks, and the strategy that is needed if the company is to survive and grow. It also requires directors to be humble enough to recognise that the board that develops that strategy is not necessarily the board that is best able to deliver it, and that there will almost inevitably come a time when it is in the best interests of the company for them to step aside.

Questions

- Does the board have the capacity to carry out all its responsibilities? If not, do you need more people or more delegation?
- How satisfactory are board discussions? Do all board members participate fully?
- Does the board collectively have sufficient expertise to understand the company's business model and performance data?
- Does the board collectively understand the views of its key stakeholders, and the likely impact on them of the board's decisions?
- What are the main challenges facing the company in the next five years? What skills and knowledge will the board need to overcome them?
- What are the culture and values the board seeks to promote, and how do you assess whether board members and candidates share them?
- Is there a skills matrix for the board? Does it include the desired personal attributes and mix (for example, diversity) as well as relevant experience?
- Is the board evaluation used to identify skills gaps?
- What knowledge and experience does senior management have, and where are the gaps? Do these need to be filled by the board or by some other means?
- Which members of the senior management team sit on the board? How open are they with the NEDs?
- When was the last time the board was refreshed? What is the average length of tenure of the current board members?
- Does the company have a formal succession plan for board member and senior management? How far ahead does it look?
- How does the board identify and select new NEDs? Is there a formal process, and how widely does it search?
- What is being done to develop potential internal board candidates?