

The coming crisis in director recruitment

...and what boards can do about it. This will include looking beyond the traditional talent pool.

BY MATRICE ELLIS-KIRK AND DALE E. JONES

PUBLIC COMPANY BOARDS that have avoided recruiting new members since the recession began will find themselves caught in a vise when they re-enter the market for directors in 2011.

On one hand, the pool of traditional candidates, which has been shrinking for almost a decade, will be smaller than ever. On the other hand, demand that was pent up during the recession will be unleashed as the economy continues toward full recovery.

The reasons for the shrinking pool of traditional director candidates — primarily sitting CEOs — are well known. Sarbanes-Oxley, activist shareholders, increased SEC scrutiny, review requirements for organizations like RiskMetrics/ISS, the need to appease Wall Street every quarter, and the threat of greater liability for directors have made board service less appealing to some CEOs. Other CEOs who serve on multiple outside boards are simply unavailable for additional service.

The growing workload for directors has also made board service less attractive to many candidates who might otherwise be willing to serve. According to the National Association of Corporate Directors (NACD), 10 years ago the average director spent about 100 hours



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— Matrice Ellis-Kirk

a year on board business and attended four meetings annually. By 2009, the number of hours had risen to 225, and the average number of meetings a year to six. During the decade, companies increasingly restricted the number of

outside boards on which their CEOs and other senior executives could serve and, in some cases, prohibited board service altogether. The recession accelerated this trend, as CEOs were expected to give their full attention to steering their companies through the economic crisis.

The less well-known story of the recession is its temporary dampening of demand for new directors, despite some high-profile shake-ups at a few troubled companies. In the midst of the greatest downturn since the Great Depression, many companies that we talk to were reluctant to swap horses in midstream, so they delayed the scheduled retirement of directors, even on boards that had explicitly adopted term limits. A number of boards that saw retirements during the recession have delayed filling those empty seats, as they waited to see which competencies they would need once the worst was over. They also did not want to spend precious time bringing new directors up to speed during the economic turbulence.

As the economy recovers and board members who had delayed retirement depart and boards begin to seek to fill open seats, the resulting increase in demand for new directors will run head-on into the sharply decreased supply of traditional candidates. Caught in this vise, many boards will need to look beyond the traditional pool of candidates to find directors who bring the competencies the board needs — a response that may look like necessity but, understood correctly, can actually be turned to advantage.

Matrice Ellis-Kirk is managing partner, Diversity Advisory Services, at Heidrick & Struggles, focusing primarily on the board practice and working with clients to develop an inclusive pipeline of talent. **Dale E. Jones** is vice chairman and partner of Heidrick & Struggles' CEO & Board Practice. He serves on the board of directors at Kohl's Corp. and Northwestern Mutual Life Insurance Co.

Looking beyond the CEO candidate

While the pool of traditional talent was shrinking, the argument for looking more broadly has been building. The increased emphasis on audit and compliance since SOX and on risk management and capital markets since the financial meltdown made CFOs attractive candidates for board seats. According to research conducted by the NACD last year, 21% of public company board members considered CFO experience critical for prospective board members (however, that falls far short of the 48% who ranked CEO experience as critical). Other highly talented functional heads have also begun to be considered as director candidates as they are increasingly expected to act as strategic partners to their CEOs.

With the coming crunch in director recruitment, boards would be well advised to expand their consideration to some additional nontraditional sources of directors, including heads of large business units, presidents, and COOs. Boards often see COOs and similar operating officers as narrowly tactical, but someone with a demonstrated aptitude for strategy, coupled with obvious operating expertise, could bring new depth and breadth to a board.

Beyond the corporate world, boards can draw on other rich pools of talent: presidents of universities and other academics, accomplished military officers, presidents of major industry associations, and public servants. Many of these leaders have the CEO-like experience that boards continue to look for, as they preside over large, complex organizations. Others bring new perspectives on the company's activities, strategy, and the world in which the company operates. A number of boards have already tapped into this talent: our research shows that 132 companies in the Fortune 500 — just over 26% — have an academic serving on their board; in 2009, 8% of new Fortune 500 directors were from academia or nonprofits. For example, Dr. Walter Massey, president emeritus of Morehouse College, served as nonexecutive chairman of the Bank of America board and serves on the board

of the McDonald's Corp. Dr. Shirley Jackson, president of Rensselaer Polytechnic Institute, serves on the board of Federal Express. Joe Frank Harris, former governor of Georgia, serves on the board of AFLAC.

Tapping a diverse pool

Looking more broadly dovetails with another argument that has gained much traction in recent years — the value of diversity. Traditionally, diversity has been seen as a matter of race, gender,



A board's deeper understanding of diversity could make all the difference in 2011.

— Dale Jones

and nationality. But in recent years, companies at a more mature level of diversity have expanded the definition to include diversity of thought and business experiences. They understand that diversity improves dialogue at the table and leads to better business decisions. In addition, they know that customers like to see people on boards who share their experiences, representing them, in effect, when it comes to important decisions. That does not mean that these companies are pursuing diversity as a numbers game; rather, they value dif-

ference for the specific benefits it can bring to the business — in diverse markets, geographies, and cultures; in the understanding of risk globally; and in understanding implications of the business that might otherwise have gone unrecognized.

The business value of such diversity is borne out by numerous studies. Research by the Executive Leadership Council shows that the higher an organization is on the Fortune 500 list, the more likely it is to have African-Americans on its board of directors. Similarly, a 2007 study by Catalyst, a leading nonprofit that works with companies on inclusiveness in the workplace, found that companies with the highest percentage of female board members outperformed those with the least by 53% in return on equity, 42% in return on sales, and 66% in return on invested capital.

Given the strong connection between diversity and business performance and the understanding that the gender, ethnicity, or nationality of board members is not about demographics but about their experiences and competencies, the raw statistics on board composition take on a new significance. Some of those numbers include the following:

- Women accounted for a little over 15% of Fortune 500 board members in 2009, according to Catalyst, a figure that is unchanged from 2008.
- African-Americans held 7.4% of Fortune 500 board seats in 2008, according to the Executive Leadership Council, down from a little over 8% in 2004, the first year the Council issued a board report.

- Hispanics accounted for less than 2% of all Fortune 500 directors in 2009, according to *HispanicBusiness* magazine.

- Asian Pacific Americans held a little over 2% of the seats on Fortune 100 boards in 2009, according to Leadership Education for Asian Pacifics (LEAP), a nonprofit leadership development organization.

What these numbers suggest is that many boards have an opportunity to secure the business value of diversity and, at the same time, address the problem of the shrinking talent pool for directors. Coupled with a determination to look

at candidates in organizations that are not traditionally sources of directors, a deeper understanding of diversity could make all the difference in 2011 for boards seeking to recruit the best available candidates.

Leveraging new proxy rules

Two of the new proxy disclosure rules that went into effect on Feb. 28, 2010, appear to support the casting of a wider net for directors. Companies must now disclose:

- Diversity policies, if they exist, and a company’s definition and consideration of diversity, with respect to directors — including a discussion of how effective

such policies are.

- The particular experience, qualifications, attributes, or skills that led the board to conclude that the person should serve as a director for the company.

Taken together, these changes offer an opportunity to make the business case in the proxy for diverse and nontraditional directors. And the two rules can be seen as mutually reinforcing. The company’s definition of diversity could include the diverse experiences of candidates from nontraditional backgrounds, and the conclusions about why someone makes a good director could include the business value of their ethnicity, gender, or nationality.

We all know from Economics 101 that you can affect outcomes by intervening on the supply side or the demand side. Since the onset of the recession, many boards have dealt with what appeared to be a shrinking supply of directors by reducing demand — even if just as a side effect of not “rocking the boat” during some tough fiscal quarters. In 2011, savvy boards will intervene on the supply side, recognizing the business value of diverse and nontraditional candidates, and reaping the business benefits that have been demonstrated to follow. ■

The authors can be contacted at melliskirk@heidrick.com and djones@heidrick.com.

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