HEIDRICK & STRUGGLES

CEO & BOARD PRACTICE

5 TRENDS IN BOARD REFRESHMENT

In corporate governance, board recruitment increasingly means board refreshment — continually improving the board's ability to oversee the successful operations of the company. Reasonable people disagree about the best mechanisms for refreshment but agree on its goals: a board composed of diverse members whose experiences, competencies, and perspectives provide the optimal mix for overseeing the company at each point in its evolution.

For the past several years, our firm has conducted two ongoing studies that together provide a unique binocular view of board refreshment. Board Monitor, initiated in 2009, tracks data on new appointments to Fortune 500 boards by gender, ethnicity, age, experience, and other attributes. The Heidrick & Struggles Board of Directors Survey, a global survey conducted annually, tracks developments across a wide range of issues in board governance. Here is what the latest editions have to tell us about trends in board recruitment and refreshment.

CEOs and CFOs rule the roost

In 2014, Fortune 500 companies filled 339 new board seats with independent directors. Current or former CEOs claimed 159, or 47%, of those seats. Current or former CFOs claimed 69, or 20%. This marks the fifth time in the past six years that current and former CEOs and CFOs together comprised two-thirds or more of new appointments.

At 47%, the CEO share of new appointments represents a drop of eight percentage points from a six-year high of nearly 55% in 2013. But it is a return to the average over the previous five years of just under half of new appointments.

At 20%, the CFO share of 2014 appointments rose more than five percentage points over the figure for 2013. Current and former CEOs and CFOs together attained their largest share of new appointments over the past six years — some 70% — in 2009, immediately following the global financial crisis.

Women gain momentum

Despite the preponderance of new appointments continuing to go to CEOs and CFOs, the overwhelming majority of whom are men, the rate at which boards are bringing on female directors appears to be accelerating. For the second consecutive year, the percentage of new female directors increased by more than three percentage points. Of the 339 new directors recruited in 2014, 99 were female, representing 29.2% of the total. That compares with 25.9% in 2013 and 22.8% in 2012. In the three years before 2012, the percentage increased only about one to two points per year.

Considering the rate of change in the percentage of female directors over the past five years, we project that by 2024 women will account for 50% of new board appointments in the United States. Just last year, using similar methodology, we projected women would not reach parity among new board directors until 2042.

What accounts for the change?

Research over the past decade has shown a strong link between corporate success and the presence of women on the board and in the ranks of executives.[1] The strong legislative push in the European Union for more women on boards has also attracted attention to the issue around the globe. And of course the topic of gender diversity remains a matter of intense discussion inside and outside boardrooms.

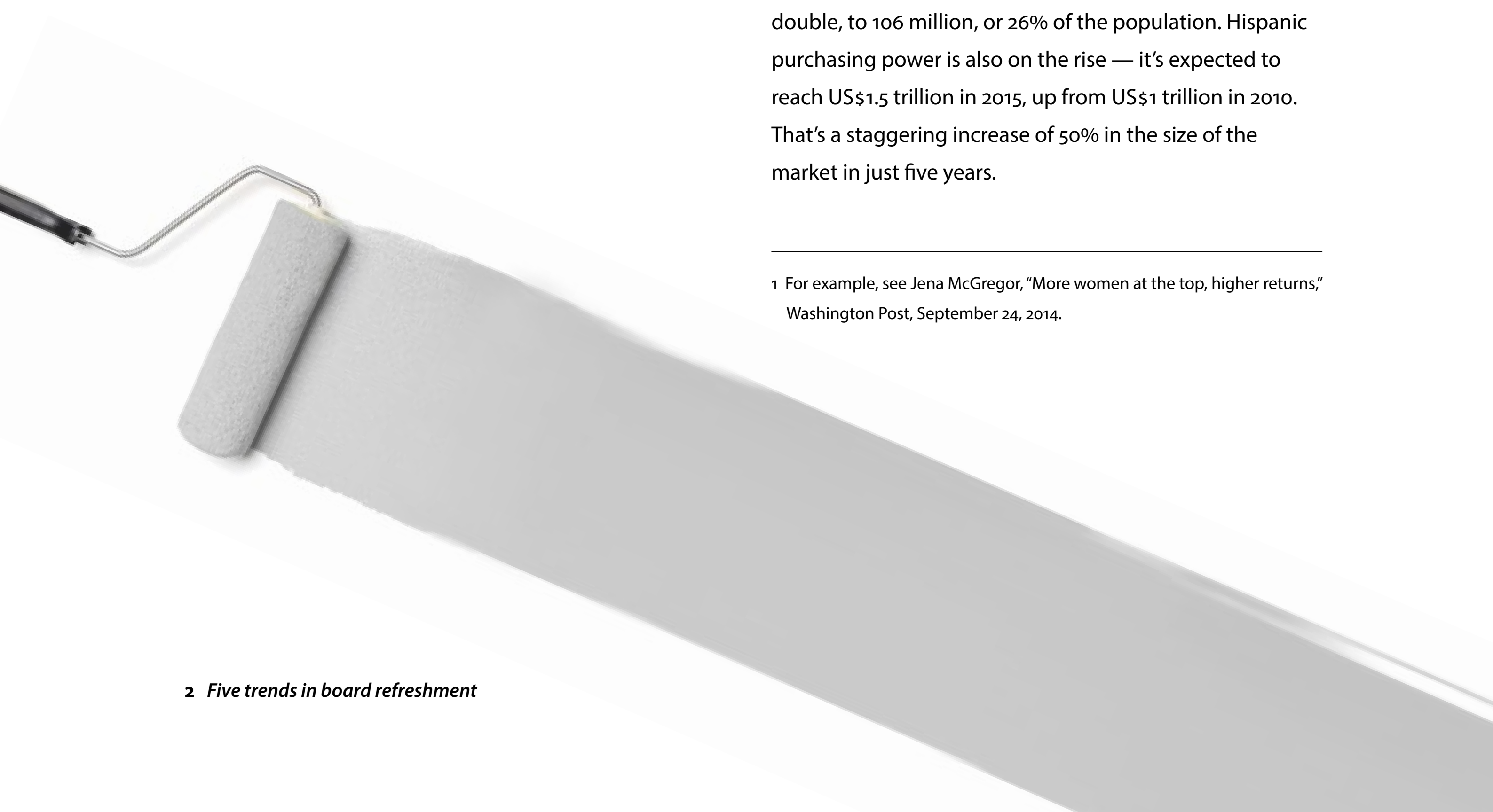
Will the momentum continue?

As a firm, we are increasingly being asked by our clients to assist in the identification of potential female directors. And we are seeing more organizations that have taken the necessary steps to increase board diversity. But a lot of hard work remains.

Mixed signals

In other areas of diversity, the findings were decidedly mixed. For example, the percentage of Hispanics recruited to boards in 2014, at 5%, remained unchanged from 2013. In fact, in the past six years the percentage has never exceeded 5.4%. Yet the US Census Bureau reports that 54 million Hispanics live in the United States, representing 17% of the population. By 2050, the number will almost double, to 106 million, or 26% of the population. Hispanic purchasing power is also on the rise — it's expected to reach US$1.5 trillion in 2015, up from US$1 trillion in 2010. That's a staggering increase of 50% in the size of the market in just five years.

1 For example, see Jena McGregor, "More women at the top, higher returns," Washington Post, September 24, 2014.



While the numbers for Hispanic directors have remained stagnant, the picture is mixed for African-Americans and Asians. Though the percentage of African-Americans appointed to Fortune 500 boards dropped from 10.3% in 2013 to 8.3% in 2014, the numbers have risen, if unevenly, since the six-year low of 3.2% in 2010. Meanwhile, the percentage of newly appointed directors of Asian origin or heritage continued to fluctuate, from a high of 8% in 2011 to a low of just over 3% in 2012.

Nonetheless, we believe that the longer-term outlook for boardroom diversity is bright and that forward-looking Fortune 500 boards will continue to seek directors who not only are ethnically and gender diverse but also can bring varied experience and perspective to bear on today's and tomorrow's tough strategic challenges.

A closer look at experience

Many efforts to profile the backgrounds of new board members look no further than the directors' most recent industry experience. But this tells only part of the story. Industry experience is a significant component of board refreshment, whether a board seeks experience in its industry, an adjacent industry, or a sector far afield. Accomplished director candidates often bring substantial experience in several industries. Indeed, our analysis found that new directors in 2014 averaged almost 2.5 significant industry experiences each.

In tracking the movement of new directors to their new boards, we took into account all of their substantial industry experiences as senior leaders, not just their most recent ones. So, for example, financial services, at 25.5%, represented the largest share of the new appointees' significant industry experiences at senior levels, whether they acquired that experience in their most recent job or at a previous point in their careers. Aggregated in this way, industrial experience, at 23%, followed by consumer experience, at 19%, represented the second and third most common backgrounds. Life sciences, at 7%, represented the smallest share of the new appointees' significant industry experiences.

Mapping the prevalence of these substantial career experiences that flowed onto boards in different industries presents a more telling picture of the actual expertise that Fortune 500 boards acquired from these new appointees in 2014. Notably, more financial services experience went to consumer and industrial boards than to financial services boards. The overwhelming bulk of industrial experience went to industrial boards, which also filled the most number of seats. Consumer experience flowed primarily to consumer boards and went to other boards in much smaller proportions. Meanwhile, business services, technology, and life sciences experience were the least well represented among new directors.

How boards approach "refreshment"

The directors we surveyed are of many minds about the mechanisms for refreshing their boards. The most frequently considered mechanisms, and directors' reactions to them, include:

Age limits

Though more than half of the respondents in our 2013 Board of Directors Survey indicated support for age limits, only 37% of directors in 2014 said their boards use them. Almost one-quarter of 2014 respondents said their boards had raised the age limit, while 11% said their boards had lowered it. And some 15% of directors who serve on boards with age limits reported that their boards had made exceptions in the recent past.

Is there an age past which directors should no longer serve? Sixty-five percent of respondents indicated that 70 to 75 years is the upper range for effective board service, while only 11% agreed that 65 to 69 years is the preferred age range for departure.

Term limits

Only slightly more than one-third of directors said their boards employ term limits, and among the nearly two-thirds of directors whose boards do not limit terms, 65% said their boards have never discussed the issue. Even where term limits are stipulated, said many respondents, the terms are often renewed several times.

Removing underperformers and directors whose competencies become less relevant

Counseling a director to leave a board, no matter the reason, makes for a difficult conversation. Nevertheless, 38% of directors reported that in the past few years their boards had asked a member to depart, opening the way for refreshment of the board.

Board and director evaluations can be a powerful tool in such instances. Ninety percent of directors said their boards conduct evaluations of the board, and 87% said those evaluations are useful. Even more to the point, 53% reported that their boards evaluate individual directors, with 77% of those respondents describing those evaluations as "robust."

The push for better corporate governance began more than twenty years ago, and it has been accelerating ever since. Discussions of director accountability, CEO succession planning, and board independence have grown in volume, intensity, and complexity. Now, as the idea of board refreshment continues to gain currency, spurred on by concerns about diversity, board composition is being cast in the spotlight and put under the microscope. While this year's data suggest that for many boards the ideal director remains a current or former CEO and that diversity remains problematic, directors take more seriously than ever the challenge of genuinely refreshing their boards. But whether we've reached an inflection point — as happened with financial oversight some years ago — or we are in for a long, slowly evolving answer to the challenge of board refreshment remains to be seen. ■

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CEO & Board Practice

The Heidrick & Struggles' CEO & Board Practice has been built on our ability to execute top-level assignments and counsel CEOs and board members on the complex issues directly affecting their businesses.

We pride ourselves on being our clients' most trusted advisor, and offer an integrated suite of services to help manage these challenges and their leadership assets. This ranges from the acquisition of talent through executive search to providing counsel in areas that include succession planning, executive and board assessment, and board effectiveness reviews.

Our Chief Executive Officer and Board Practice leverages our most accomplished search and leadership consulting professionals globally who understand the ever-transforming nature of leadership. This expertise, combined with in depth industry, sector and regional knowledge, differentiated research capabilities and intellectual capital, enables us to provide sound global coverage for our clients.

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