Building the foundation for better board refreshment

Today, change and unpredictability seem to be the norm, and boards are faced with more ever-changing responsibilities on top of their traditional concerns. As boards add new directors, they are increasingly struggling to find the right balance among their current structures, refreshment, and maintaining a healthy board culture. The right first step is assessing whether the basic structure is still fit for purpose.

Boards take their own succession planning seriously. Today, more public company boards work harder to align their composition with their company's strategy, for example, and to focus more on the value of diversity in making better decisions as well as meeting stakeholder expectations.[1] Directors are serving for shorter periods, Heidrick & Struggles analysis shows: the average tenure for Fortune 500 directors has fallen from 12.3 years in 2010 to 6.7 in 2020. But despite solid efforts, boards are too often unable to change as fast as conditions require. One reason for this is simply that most people find it hard to plan for their own succession. In addition, we see three main structural reasons: typical planning focuses more on process than outcomes, board cultures make it difficult for chairs to make changes outside those processes, and chairs don't have enough time to spend on refreshment given everything else they have to do.

All that has to change. Boards, especially the chairs of nominating and governance committees, should start by taking a step back to assess whether their current size, term length, term or age limits, and current cadence of refreshment are still appropriate. This should be done through the lens of the company strategy, shareholder expectations for sustainability and diversity, and in the context of the current global political environment. These considerations will likely give new context and flexibility to boards' regular assessments of their needs—as well as require additional changes in processes and board culture.

1 For more on how boards should approach succession overall, see Bonnie W. Gwin and Jeffrey Sanders, "Board succession 2020: Three steps toward long-term effectiveness," Heidrick & Struggles, August 13, 2020, heidrick.com.

Why boards get stuck

Boards have generally had 9 to 12 members for the past couple of decades, though their size has fluctuated in response to the market and overall conditions. In the United States, in particular, boards have been getting smaller as chairs try to create greater cohesion and alignment. New members would join a board in a regular cadence, most often based on their expertise, and, in most countries, as former CEOs or CFOs or having been members of other public company boards.[2] Members would serve for the full term allowed by regulations or bylaws, usually 9 to 15 years depending on the country, or until they hit a mandatory retirement age. Many US boards have mandatory retirement ages, but only about 20% of the Fortune 500 companies, for example, have term limits today. In Hong Kong, many directors have one-year terms, but the expectation of serving until the maximum of nine years is almost universal. The board refreshment process has traditionally involved little to no assessment of board performance as a whole or of individual directors' contributions. And, as the pace of change in industries, economies, and societies has increased—and particularly in the wake of disruption driven by the COVID-19 pandemic—boards have to up their game just as much as executives.

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The conundrum for chairs and nominating committees has been that the regular cadence of refreshment, taking into account full terms, hasn't allowed enough room to add expertise in newer areas such as digital or sustainability or to improve diversity nearly as much as companies need and stakeholders expect while still meeting boards' need for more traditional types of expertise. The current situation is not only making boards less effective than they could be; some institutional investors have begun to increase pressure for more frequent board refreshment.

Some boards have responded by expanding by a member or two or by setting up ad hoc or advisory committees in various areas. That's helped, but not enough, in part because of the weight of other traditional processes and norms such as agendas, the way conversation is managed in the boardroom, and avoidance of discussing director performance.

Questions to get started

Boards need to start by making the time to assess their role in the context of today's and, possibly more important, tomorrow's environment. Particularly now, that requires considerations that go far beyond business strategy, taking into account organizational purpose, pandemic recovery, and political volatility, among many other considerations.[3] Taking this time will allow chairs and nominating committees to understand if they need to make changes to cadence, term length, term or age limits, or board size.

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If it is clear, for example, that a board will need long-term expertise in sustainability to support the company's purpose and strategy, is that need as important as traditional financial expertise or industry expertise? If all of those types of knowledge are now equally important to the board's effective functioning, does the board need to grow permanently? How would that affect dynamics in the boardroom? Should sustainability become a permanent agenda item?

If it's clear that a board needs restructuring expertise, it's likely that won't be a long-term need. How can the chair and the nominating committee change board members' expectations about how long they will serve? Should different incoming directors have different expectations? What about current directors? How would such differences affect the ability to recruit new directors and the dynamics in the boardroom?[4]

Has the industry—retail, for example—changed so much because of digitization and the crisis that the expertise of a retired CEO is no longer particularly helpful, but he or she still expects to serve another six years? Would regular board effectiveness reviews help pinpoint where directors contribute less without making assessments personal? Would such reviews help the chair change expectations about re-nomination? Or is it the division of labor that needs to change, with a newer and more digitally dexterous director taking the lead in strategy discussions while the retired CEO lends experience to crisis management? What will help the chair make that shift in dynamics work?

Or, are good governance steps like term limits actually hurting a board because it's losing too much institutional knowledge? In resource-intensive industries, for example, companies make fifty-year investments. What term limits are appropriate for this industry and the decisions this board needs to make? How would changes to term limits affect the dynamics in the boardroom and interactions with the executive team?

2 For more details on these trends, see *Board Monitor US 2020*, Heidrick & Struggles, September 9, 2020, heidrick.com.

3 For our perspective on potential scenarios for the future of work, see Yulia Barnakova, Scott Snyder, and Eric Skoritowski, "COVID-19 and the future of work: Four scenarios," Heidrick & Struggles, April 14, 2020, heidrick.com.

4 For more on restructuring, see Elisabetta Bartoloni, "Restructuring expertise: Bringing a new voice to the boardroom," Heidrick & Struggles, May 21, 2020, heidrick.com.

Five questions for boards to consider

- ☐ **People, planet, profit:** What is our organizational purpose, and what is our purpose as a board in support of it?
- ☐ **Perspective:** What do we as a board need to know to support the executive team in developing and executing a strategy to meet that purpose while operating profitably and with good governance? Is the expertise of the current board still the right mix?
- ☐ **Power:** Is our board culture inclusive, supporting all members in contributing their expertise equally to decision making, or are decisions influenced by side conversations or other power dynamics? Are directors' expectations about how long they will serve aligned with the company's current needs? How can we shift the culture to create an effective balance of power?
- ☐ **Priorities:** Does our agenda reflect where we as a board can add the most value to the organization? Where do we need to add new areas of expertise first? Which current processes are most ineffective and should be changed first?
- ☐ **Process:** Does our current board size allow us to have the right mix of expertise for today and tomorrow? Does our current cadence of refreshment allow us to keep up with the pace of change in our industry? Does our agenda reflect where we as a board can add the most value to the organization?

Once boards have answered questions like those above, their regular review of board composition against strategy will take on a new flexibility. It's likely most boards will also find an urgent need to change culture and other processes if they do make structural changes.

Making change stick with processes, culture, and feedback

Reassessing these structural basics is a hard step, but it is only the first one. Boards then need to make the change work. That may require bylaw changes or regulatory filings, but will certainly require culture change, which is usually difficult. Many boards, however, have succeeded in other ways, such as becoming more inclusive of directors with non-traditional backgrounds, and that gives them some experience to build on.

Our experience shows that shaping a new culture starts with personal change among leaders, and so a crucial first step for chairs will be engaging their fellow directors in the need for change. For some of these directors, the change will likely end their board service early; one tactic that can help is finding other ways for them to continue to be involved in the company, perhaps as a mentor to board members or as an adviser in special situations.

More broadly, it will help if boards are able to create a feedback culture in the boardroom. Too often, board chairs and directors have informal conversations about how things are going but regular assessments of board effectiveness and the effectiveness of individual directors are unusual. Making those assessments a normal part of board operations will help directors get used to discussing where they, as a group, are being most and least helpful to their companies.[5] The culture will then slowly shift into one in which it's easier to change expectations about agendas, terms, or who should lead discussions. Without such change, no amount of structural change will make a difference; with it, boards have a chance.

It's crucial, however, that chairs don't let a feedback process become simply a tool for removing a known poor performer. We have seen that approach cause directors to shut down and lose faith in a process that should be supporting the board. Separating individual performance discussions from re-nomination discussions will help. One example of a productive way to do that is to conduct individual director assessments in the first year of a typical three-year board term, two years removed from any re-nomination decision.

Public company boards have been improving their long-term refreshment practices in recent years. To ensure their boards are most effective today, chairs need to take a step even further back and rethink their fundamental structures to set the context for success.

5 For more on board reviews, see Alice Breeden and David Hui, "A board review that accelerates competitiveness," Heidrick & Struggles, April 16, 2020, heidrick.com

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