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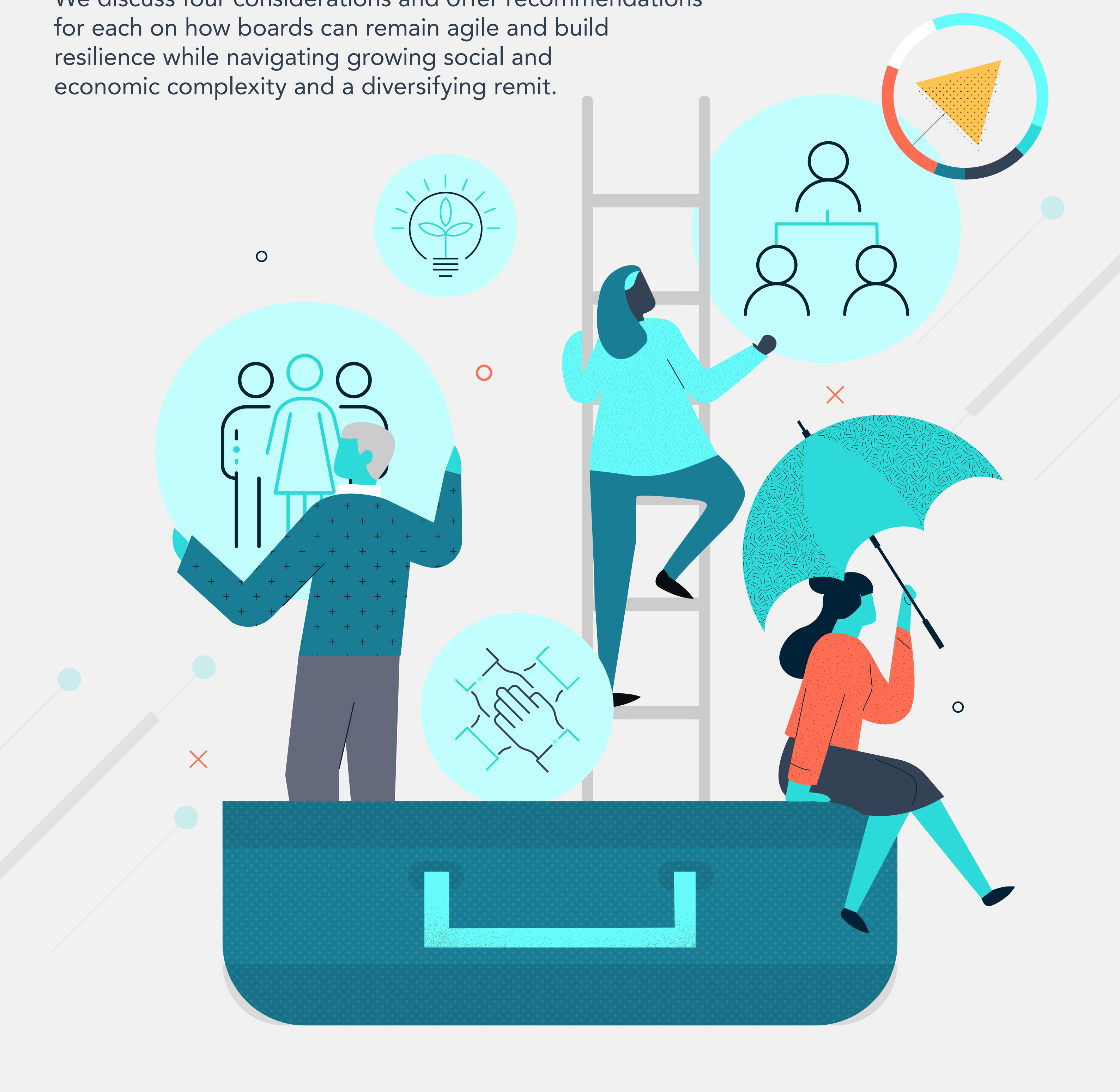
From custodianship to stewardship: Considerations for European boards

We discuss four considerations and offer recommendations for each on how boards can remain agile and build resilience while navigating growing social and economic complexity and a diversifying remit.



Corporations' license to operate has been changing markedly over the past few years, with society increasingly demanding that businesses and business leaders step up to fill a perceived vacuum of political leadership on social and environmental issues.[1] Compared with companies based in Asia and North America, European companies have long paid more attention to many such considerations, though there are, of course, vast differences among European countries.

Ongoing labor disputes, social and racial justice movements, political instability and conflict, and the COVID-19 crisis have created a sense of tension and uncertainty. Due in part to the Russian invasion of Ukraine, Europeans in particular have been dealing with an exponential rise in the cost of living, straining entire economies. And as war and climate change increase the numbers of refugees, many European nations are struggling to find the resources to provide for those in need. And there is no end in sight to many of these issues.

In most countries corporate leaders now must meet a triple bottom line: people, planet, and profit.

As a result, boards' remit is expanding and diversifying. There is increased accountability for leaders: some countries have set regulations around the liability of senior leaders (including boards) and shareholders and investors are demanding more transparency. Environmental, social, and governance (ESG) issues are becoming core operational pillars and are increasingly instrumental in corporate access to capital. Fundamentally, in most countries corporate leaders now must meet a triple bottom line: people, planet, and profit. We believe that the most effective boards will rethink the structures and culture of today's boardroom to govern in the evolving business world.

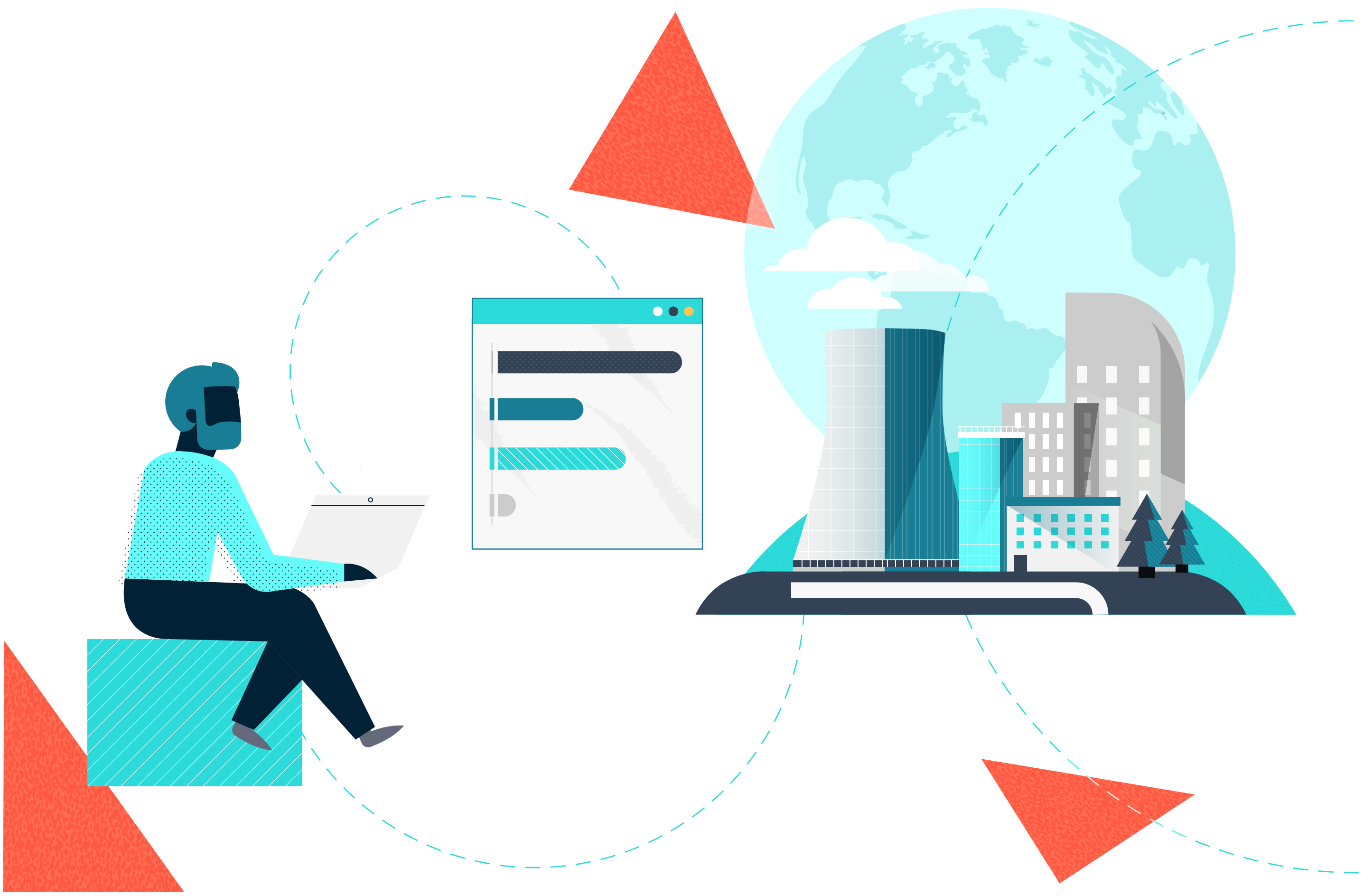
To do this, though, it is imperative that boards are able to function with agility, resilience, and a long-term outlook. Especially in uncertain and unpredictable times, boards' ability to pivot quickly and be constantly adapting to meet ever-evolving requirements, competition, talent needs, and technologies will be key to organizational success. In light of this evolving license to operate, we offer insights based on our discussions with directors across Europe on four ongoing challenges for boards.

1 *Edelman Trust Barometer 2023*, Edelman, edelman.com.

1. Sustainability

Climate change is one crucial factor fundamentally reshaping the role of the board right now. The European Union is one of the most progressive markets in regulating sustainability, and climate response in particular. The Glasgow Climate Pact of 2021 saw nearly 200 countries agree to strengthen their targets for cutting greenhouse gas emissions. COP27, held in Egypt, focused on implementation and a renewed sense to accountability toward the commitments made by the business world. However, the UN has made it clear that the world is still lagging badly in its efforts to cut emissions, with "no credible pathway" to avoid breaching an agreed limit of 1.5C in global heating.[2] And COP28, to be held in the UAE, is already generating controversy due to accusations of greenwashing aimed at the president, Sultan Al Jaber.[3] We believe that only the private sector can unlock the very large amounts of capital required to curb emissions enough to avert this crisis—and turn these challenges into opportunities for innovation and new growth. Wise boards are making sure their companies are in the vanguard of those acting to meet these rising concerns—before they are forced to.

According to a global survey of board members we conducted in partnership with INSEAD and BCG in the spring of 2023, sustainability is now a firm fixture on board agendas. A strong majority, 79%, of respondents said their board has a very or entirely clear understanding of the strategic opportunities and risks sustainability presents—but only 29% completely agree they have sufficient knowledge to effectively challenge management on sustainability plans and exercise oversight on their execution.[4]



2 Oliver Milman, "Cop26 one year on: how much progress has been made?" *The Guardian,* November 8, 2022, theguardian.com.

3 Ben Stockton, "Cop28 president's team accused of Wikipedia 'greenwashing,'" *The Guardian*, May 30, 2023, theguardian.com.

4 Forthcoming Heidrick & Struggles, BCG, and INSEAD report.

Most board members we have talked with are caught in a vicious circle: people who understand the implications of climate change and how to address them typically lack the business experience traditionally required to join a board, and people with board-relevant business experience do not know as much as they would like to about the long-term business implications of climate change. In order to stay abreast of the challenges of climate change and the risks it poses to organizations, boards should:

- **Include climate change in your board's competency matrix and make sure there is sufficient expertise to manage climate risk.** The board must be aware of what climate change means for the business, as well as how they will play their part for their company and their communities.
- **Add more relevant voices to your boardroom.** Once climate change is part of your board's competency matrix, finding the directors to meet it, both in terms of their experience, technical expertise and their ability to influence their peers to join them in their goals, must become a high priority—one that directors should hesitate to trade off, both to save the planet and to safeguard their company's ability to create value over the long term.
- **Change the board processes and dynamics.** You will need to spend more time on climate change than you think and, to make it stick, formalize the time you spend. Our forthcoming survey report found, for instance, that while 70% of respondents say that sustainability metrics and decision-making is integrated into the board agenda, 90% believe it should be. And while 69% say that sustainability considerations are integrated into investment decisions, 87% say it should be, ideally. Indeed, we recommend that boards systematically include climate-related issues into their annual schedule. It is also a good idea to integrate climate considerations into traditional agenda items, considerations such as; stakeholder engagement and scenario planning and risk assessment in addition to investment decisions, as well as embedding these initiatives at committee level—particularly audit, remuneration, nomination, and risk.[5]
- **Anchor your climate change strategy in social and organizational purpose and connect it to specific operations.** Organizations that deliver on a meaningful purpose have an increasing edge over others. Connection to purpose builds energy and trust. Boards and executive teams who put climate change at the heart of their purpose can significantly accelerate their progress.
- **Integrate climate change objectives into executive compensation and search strategies, especially for the CEO.** Overseeing executive performance and recruiting new CEOs are fundamental board duties. It follows that climate change should become fully integrated into these activities—and that, just as board members need to be continuously examining their own succession plans, they must do the same for their CEOs. Boards need to define a chain of accountability for climate change considerations.

5 For more, see Alice Breeden and Claire Skinner, "European boards and sustainability: Charting the green recovery," Heidrick & Struggles, heidrick.com.

2. Diversity, equity, and inclusion

We believe the connection between DE&I and business success is basic: every corporate leader wants to improve employee engagement, attraction, and retention. And, according to a recent Heidrick & Struggles survey of 420 executives from eight countries, these are the ways in which respondents most often saw their DE&I efforts contributing to business success.[6] Yet for too long, in most companies, DE&I efforts were marginalized, of interest only to a few HR executives. In the past decade, that has changed for the better. Now, the greater expectations for corporations to meet broad social needs, combined with many employees' growing preference to work for a company with values that match their own as well as a greater ability and willingness to switch jobs, have all led to a new and comprehensive focus on employee diversity and inclusion from senior leaders.

In Europe, some countries have a broader focus than others. For example, ethnicity, LGBTQ identity, and socioeconomic class are more in focus in the United Kingdom than some other countries. But gender diversity is the common denominator. The European Union will require its member countries to allocate 40% of board seats to women before June 2026. The United Kingdom is set to go one step further, asking for clearer representation in roles of influence as well as for representation of ethnicities other than white.

But identifying and taking effective actions is hard. One reason is fatigue: it's been a long few years for everyone, and DE&I efforts are among those where progress can be hard to see and resistance is more common, leaving leaders overwhelmed.[7] Other reasons are that companies are in very different stages of progress on DE&I, facing different regulations, and working with a unique culture. So, although there are common tactics to make progress on DE&I, those tactics need to be adapted to each organization—and, most important, visibly committed to by leaders and woven through the company's processes, operations, and incentives.

In order to build diverse and inclusive organizations, boards should:

- **Ensure your organization has clearly defined each of diversity, equity, and inclusion** and make sure everyone on the board understands what you mean when you use those terms.
- **Consider how everyone can move forward together into a new culture.** At many companies, close to 40% of employees have joined since January 2020 and hybrid work has raised a range of inclusion questions. The sense of the culture and inclusion may differ between new hires and longer serving employees—and board members.
- **Take a systematic, enterprise-wide approach to DE&I.** This means working with the leadership team to leverage existing systems for driving change or creating new ones, measuring your progress, and communicating your results to employees.
- **Engage and talk to stakeholders, including employees, about DE&I.** Demonstrate commitment.

6 Jonathan McBride, *Employees at the Center: What It Takes to Lead on DE&I Now*, Heidrick & Struggles, heidrick.com.

7 James Serrano, "Here's a Large Obstacle to DEI You've Probably Overlooked—and What to Do About It," LinkedIn, September 20, 2022, linkedin.com.

The board's role in talent risk management

In recent years the scope of what is considered risk management has broadened and become a governance issue that is "squarely within the oversight responsibility of the board."[1] Risk management now encompasses everything from financial and credit risk to climate risk[2] to areas that impact talent attraction and retention. Through its oversight role, the board must demonstrate to management, employees, and other stakeholders that "comprehensive risk management is not an impediment to the conduct of business nor a mere supplement to a firm's overall compliance program. Instead, it is an integral component of strategy, culture and business operations."[3]

Regarding talent risk in particular, the trends of the past few years make it clear that individuals' needs and expectations are changing and society's along with them. Attracting and, perhaps more importantly retaining talent will require a dedicated emphasis on making sure that organizations stay abreast of the evolving and unstable marketplace, in which employees are less anchored than ever before. While companies have been recalibrating in the current marketplace, workers—especially younger workers, the leaders of tomorrow—have made it clear they are ready and willing to leave workplaces that do not align with their values and needs. We believe leaders can choose to see these times as an opportunity as well as a challenge; organizations can seize on the chance to build a truly innovative workplace of the future, one that will fulfill employee, customer, and societal needs for generations to come. Boards must empower their organization's leadership team to innovate, fostering a culture of inclusion and openness to creative approaches to working norms.

1 Martin Lipton, Sabastian V. Niles, and Marshall L. Miller, Wachtell Lipton Rosen & Katz, "Risk management and the board of directors," Harvard Law School Forum on Corporate Governance, March 20, 2018, corpgov.law.harvard.edu.

2 For more on climate risk, Elizabeth Langel and Sarah Sliva, "Financial services focus: The emerging role of the climate risk officer," Heidrick & Struggles, heidrick.com.

3 Martin Lipton, Sabastian V. Niles, and Marshall L. Miller, Wachtell Lipton Rosen & Katz, "Risk management and the board of directors," Harvard Law School Forum on Corporate Governance, March 20, 2018, corpgov.law.harvard.edu.

3. Culture

Organizational culture has become an increasingly high priority for leaders in recent years. Even before the COVID-19 pandemic, many executives leading in a quickly changing business environment with an evolving talent pool were seeing that a thriving, inclusive culture could provide a competitive edge in innovation, employee attraction and retention, and agility, among other areas. Now, as boards seek to guide companies in a volatile environment with intense competition for talent, linking organizational purpose with day-to-day work in a way every employee can feel and participate in is key.

Boards set the tone for the whole organization.[8] The most effective boards focus on working through difference to create sustained long-term value across competitive, cultural, geopolitical, and societal boundaries, and communicate plainly and honestly in virtually every setting. Ensuring this level of leadership on the board and from CEOs is now arguably the board's most important responsibility.

According to a recent survey of 500 executives around the world, Heidrick & Struggles found that the share of CEOs who believe that culture is a top-three influence on financial performance increased significantly from 2021 to 2023.[9]

However, those executives showed a disconnection between the elements of culture CEOs think are most important to improved financial performance, such as having direction and purpose and a mindset of agility, growth, and innovation, and which elements are actually most prevalent in their companies today. Boards must reinforce the links between purpose, culture, and performance wherever they can. Amid all the other goals companies have in today's uncertain world, internal efforts such as culture can sometimes be treated like afterthoughts. But our survey shows that companies that link culture to strategy and focus on people first also see better financial performance.

Our four principles of culture shaping are cultivating **purposeful leadership,** encouraging and exploring **personal change,** building **broad engagement,** and ensuring **systemic alignment.** For boards right now, they can start by:

- Making culture impact, including impact on a broad range of DE&I, environmental, and community-facing responsibilities, a significant element in CEO succession planning
- Making reviewing culture metrics a part of their regular schedule, and making improving those metrics a performance metric for the executive team
- Setting high-level culture aspirations for the company and communicating them clearly to both internal and external stakeholders
- Using regular pulse surveys on culture and engagement to make an overt link between culture and business performance

8 Alice Breeden, Rose Gailey, Ian Johnston, and Kate Rankine, "Getting on board with culture," Heidrick & Struggles, heidrick.com.

9 Forthcoming Heidrick & Struggles culture survey.

4. Succession planning

While board members have historically considered CEO and board succession to be one of their most important responsibilities, in our experience, fewer companies have formal, written succession planning processes at any level. Many board candidates are found through longstanding networks and simply waved through an election process. In such uncertain times and with so much at stake, organizations cannot afford to overlook what is necessary to guarantee they will have the leaders to take them into the future.

In recent years, there has been an increased push for gender and ethnic diversity. We have also seen a call for directors with digital transformation and cybersecurity experience. And boards need to continually assess their technological and digital acumen to make sure they are in the best position to make decisions in an increasingly digital and technology-dependent environment. Our *Board Monitor Europe 2023* report found that the addition of board directors with sustainability and cybersecurity experience remained steady, at 10% and 5% of new appointments, respectively. However, while the experience of board members must diversity along with the board's growing remit, boards must be cautious that they do not entirely forego traditional management experience for specialized experience. Boards can no longer afford to reduce "succession planning" to a reactive, short-term project employed to address a near-term or likely vacancy, or a crisis.[10]

Boards may consider, for example, adding these members with narrow but deep expertise in order to bring the entire board up to speed rather than as a permanent addition to the board's skills matrix. With a long-term mindset, the board will be able to move forward equipped with the knowledge it needs, moving from a reactionary, catch-up playing mindset to a more proactive, consistently prepared state. Boards can no longer afford to reduce "succession planning" to a reactive, short-term project employed to address a near-term or likely vacancy.[11]

In our view, the scope, timing, and processes for both board and CEO succession need to change. Anecdotally, we are seeing an increase in the number of boards experimenting with novel approaches to succession at both the CEO and board level. We believe this reflects a growing belief that succession planning, for both the CEO and the board, lies squarely at the center of whether the company is ready to meet its expanding responsibilities.

Indeed, boards that are increasing their investment in succession planning are finding the process a powerful frame for clarifying their growing responsibilities. Done well, succession planning forces a prioritization around those issues most material to each company and the community that surrounds it, and then builds a process to develop the knowledge, governance structures, and leadership capabilities needed to meet those issues. In addition, proactively cultivating board and CEO talent, refreshed across multiple time horizons and strategic scenarios, reduces risk and builds confidence that the organization will be governed well in any new environment.

10 Jeremy Hanson, "CEO and board succession in the age of impact," Heidrick & Struggles, heidrick.com.

11 Jeremy Hanson, "CEO and board succession in the age of impact," Heidrick & Struggles, heidrick.com.

In order to find and keep the best leaders for their organizations' futures, boards should:

Invest in succession. Increase your investment in succession and connect it to strategy. Make certain your strategic planning, scenario planning, enterprise risk management, business continuity planning, and succession planning (CEO and board) are woven together.

Be intentional about diversity. Be intentional about developing diverse pools of candidates. Put candidates of underrepresented groups on career paths and provide them with opportunities for growth than can lead to roles more conductive to eventual board and CEO roles.

Disclose leadership and governance risk. Be clear about these liabilities in your regulatory filings and openly communicate how your succession planning process addresses those risks.

Build your bench. Reactive, event-driven recruitment projects are a thing of the past. Build a dashboard that identifies prospective board candidates and both internal and external CEO candidates, refreshed continuously over multiple time and strategy horizons. This information should be available at any time and reported at least quarterly to the nominating and governance committee and bi-annually to the full board.

Strengthen employee representation. Formalize non-voting mechanisms that ensure the voice of non-management employees are heard in the boardroom.

Encourage responsible turnover. Install term limits for board service that match your business model. Aggressively replace poor performers.

Expand boardroom expertise. Identify the broader skills needed in your boardroom and expand boardroom expertise. Push the board competency matrix thinking to include skills and experience most material to your company and the communities you serve. Use mechanisms such as ad hoc committees, observers, advisors, on-demand talent platforms to surround the board and CEO with the broad and rapidly changing skills needed to govern in this expanding environment. Expect resistance.

Tune in to tech. Hone your digital capabilities and ensure the boardroom can respond to the opportunities and risks stemming from the evolving digital and technological landscape—particularly the advancements in artificial intelligence and machine learning.

In these uncertain and unpredictable times, boards' ability to pivot quickly and be constantly adapting to meet ever-evolving requirements, competition, talent needs, and technologies will be key to organizational success—and those abilities hinge on a board's willingness to innovate, expand its capabilities, and become comfortable with uncertainty and ambiguity. In other words, boards must function with agility, resilience, and a long-term outlook—one that acknowledges the changes in society as an ongoing evolution, not the result of temporary upheaval. Boards with a thorough understanding of the main ways in which their remit is diversifying, a proactive approach to oversight and governance, and a healthy balance of traditional and nontraditional expertise will be best equipped for the future.

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CEO & Board of Directors Practice

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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.

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