



HARCOURT BOARDROOM RESOURCES

# SELECTING A NEW BOARD MEMBER



Board composition attracted relatively little attention a decade or so ago. Directors were often recruited on the basis of their personal relationship with the Chairman or the CEO, or their alleged ability to attract business or political favors. Boards competed to attract “trophy” personalities, with little regards to their actual expertise, ability to function in a group, understanding of the sector – let alone business acumen or availability. Once in a while, often after a crisis, a board realized that it needed high quality, competent individuals, who had the time and interest in “doing the job” and taking on the responsibility.

This somewhat simplistic description of board recruitment has never been totally true, of course – many boards have always tried to recruit the “right” individuals, giving due respect to cultural biases and prevailing business practices. Nor has it completely disappeared today, even after the financial crisis has highlighted the damages caused by inadequate boards and board recruitments. It is clear, however, that board recruitment is now a major area of focus and preoccupation for boards, board chairmen or lead directors.

There are many variations on the basic questions (outlined below) a board must ask itself, depending on the culture and needs of the company and of its board, the shareholding structure, the individuals involved, etc. But all boards looking for a new member will, more or less rigorously, ask themselves the following questions.

## SHAREHOLDING STRUCTURE?

Large shareholders (families, states, financial groups, etc.) generally want to be represented on the board (their representatives are called “nominee directors” – See “Nominee Directors in Groups “- Harcourt IGN, January 2016). But that is not always the case, as being on a board might limit the possibilities of exit (in particular because of “insider information” limitations).

The answer to the question will really depend on whether the large shareholder wants to have influence on the management and strategy of the company, or wants to hold the participation on an “arm’s-length” basis. In the first instance, the shareholder should be represented, whereas in the second he should not. It is fair to say, that many shareholders (particularly state shareholders) claim they want to manage their participation on an “arm’s length” basis, but find it very difficult to restrain from getting involved. As a result they apply

pressure directly or indirectly, outside the boardroom, which is neither transparent nor sound.

## SIZE OF THE BOARD?

Corporate law generally defines the maximum size of the board, and that number has gone down in recent years. When the idea was to “stuff” the board with as many “grandees” as possible, the maximum size was often attained, to the detriment of efficiency and transparency, as roundabout methods of decision-making had to be implemented (delegation to one committee of all the important decision, decisions outside the boardroom, etc.). In practice however, board’s functioned under their maximum number of members, as some directors were really “absentee members”, lending their name more than their time, judgement or skills.

Most boards now accept that the optimum size for efficient decision-making is 8 to 12 members, and “absentee directors” are seriously frowned upon. There is some flexibility around these numbers, for example for smaller companies or companies in transition from one governance regime to another.

## WHO ELSE DOES THE BOARD NEED?

Most boards ask themselves this question, whether formally or informally. There is only benefit in putting formally this question on the board table on a regular basis.

This is one of the purposes of the annual board evaluation (See “The Board Evaluation Process” – Harcourt IGN, January 2016). It is also one of the main responsibilities of the Nomination and Governance Committee – or equivalent committee of the board.

The answer to this question is complex, as a board appointment is often meant to answer multiple needs. Considerations of expertise, diversity, board dynamics, and reputation, all come into play.

## EXECUTIVE OR INDEPENDENT DIRECTORS?

Executive directors have management functions – the CEO, the CFO or other CXOs. The range of what is authorized by regulatory frameworks and what is the business practice is quite wide. In certain jurisdictions, the board can only be composed of non-executive directors, while others commonly admit the CEO, and some have two or more executive directors.

Where permitted, the board should ask itself if any of the senior management should be formally appointed as a director. In practice however, whatever the decision on this point, the CEO will normally attend most of the board session, as will the CFO and the General Counsel. So if the CEO and others become directors, the board must be clear as to why the formal appointment to the board is necessary.

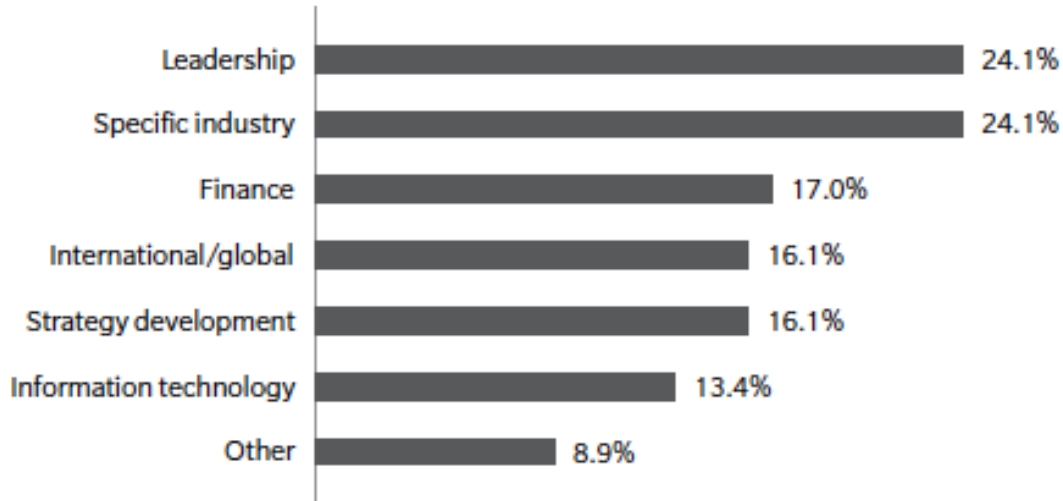
The definition of independent director varies slightly from jurisdiction to jurisdiction (see “Independent Directors” – Harcourt IGN, February 2016), but all definitions ensure that the independent director will have neither management responsibilities nor significant financial interest in the company – shareholding, contractual or other. Many jurisdictions will mandate the number of independent board members, even in the case of non-listed companies.

Deciding whether to appoint an independent director is an important step for family companies, as it is for state-owned companies, private-equity held companies, and holding companies for their subsidiaries.

Finally, determining whether a candidate is “independent” is fundamentally a board decision, whatever the independence criteria laid out by the board or by regulations. It must also be checked annually, as a director’s personal circumstances can vary.

## SPECIALIST OR GENERALIST?

Table 1: Areas of Expertise in Director Recruitment



Source: NACD 2015-2016 Public Company Governance Survey.

A candidate is always identified on the basis of a set of experiences or skills the board feels it is lacking. Table 1 gives an example of the areas of expertise respondents of US listed companies gave to a 2015 survey conducted by the NACD (US National Association of Corporate Directors). Similar surveys elsewhere in the world would most probably yield similar results.

But if a candidate is always chosen for expertise in one or more areas, the director must in addition quickly become a generalist – of board practice and behavior, of the sector or the industry, of business in general. A director who remains the “expert” on the board is unlikely to be a good director, nor be respected by his or her peers.

## DIVERSITY?

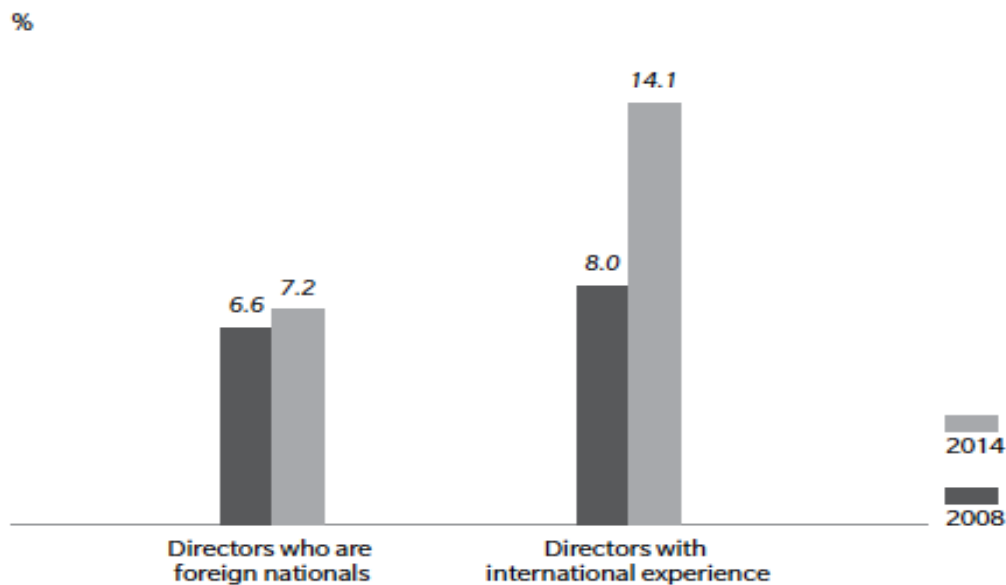
The literature on gender diversity is immense – and generally useless. In practical terms, boards should ensure that they consider candidates from both genders, and systematically

ask the question of gender representation. They should also be prepared to widen the search criteria and bet on younger candidates.

Skewing selection criteria to achieve better gender balance in the boardroom may be a perfectly valid political, reputational or even managerial objective, as long as the standards for competence and expertise are not lowered. Many countries mandate gender ratios, and boards must still strive to find the best candidates.

As difficult a question as gender diversity is the question of whether a board should force better international representation, by prioritizing either candidates with international experience, or foreign candidates. Table 2 shows the board level geographic diversity the S&P 500 in 2014.

Table 2: “Global Directors”-S&P 500



Source: 2014 Global Board Index, Egon Zehnder.

The bottom-line is that, despite much publicity and attention, “global directors” remain a small minority. The S&P 500 may not be representative of companies headquartered in “open” economies, but even there, good “global directors” are difficult to find and difficult to attract. Most boards keep an open-mind on this question, but when decision-time comes,

Table 1 shows that industry expertise, financial or IT skills will generally trump international business skills. There are exceptions, of course, where these skills become a “must have” rather than a “nice to have”.

## THE SELECTION PROCESS ITSELF

The process for selecting a director resembles any top level recruitment in a company, from CEO to Chairman or top level executive.

Some of the important points for a board are the following:

- Awareness of the needs: A board must constantly be aware of what it needs and what it lacks – hence the annual board evaluation, and regular discussions at the board itself.
- Nomination and Governance Committee: The task of monitoring the board’s needs, of keeping an eye for potential candidates, of dealing with the search firm (if one is used), of interviewing candidates in the first instances, is generally given to a special board committee (Nomination, Governance, or similar). Many jurisdictions have strict requirements as to the composition of this committee. It is often chaired by the chairman, who plays a key role in board composition and the director selection process.
- Search firm: Like in the CEO selection process, there is little downside in using a search firm, and it can be very useful. It will provide better objectivity in the discussions, some element of benchmarking, can facilitate the initial approach of high level candidates, and may even come up with interesting names. It is fair to say, however, that a board often has all the right names in mind.
- Interviews: It has become the norm that candidates be interviewed by multiple directors, whether members of the committee in charge of the process or not. An increasing number of boards want a candidate to be interviewed by all the board

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members. Needless to say, this lengthens the selection process, but is often well worthwhile for board and the candidate.

- Expertise and personality: A candidate must not only have the required skills, but also have the maturity and personality to function well in a board context. Assessing these “soft” elements properly is key in ensuring that the new director will actually add to the board’s effectiveness and overall quality.
- Duration: This can vary enormously. Whilst a board should be prepared to act and decide quickly, the process can take quite a few months, particularly if all directors have to interview the candidate(s).

Harcourt IGN, January 2016