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THE HEIDRICK & STRUGGLES BOARD MONITOR

Trends in board composition over the past five years

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Five years ago, Heidrick & Struggles initiated the Board Monitor, designed to capture key characteristics of newly elected independent directors of Fortune 500 companies, track that data from quarter to quarter and year to year, and provide a springboard for discussion of board composition, diversity, and governance. Here is what that data has to tell us about trends in director appointments over the past half-decade.

The five years since the inception of the *Heidrick & Struggles Board Monitor* have seen a series of events that reverberated in boardrooms around the world: a great recession, more stringent regulation, and greater accountability for directors. At the same time, the push for diversity grew stronger than ever. Organizations dedicated to diversity launched joint initiatives with corporations to address the issue; in the US, SEC regulations called for more transparency about diversity and the selection of directors; in the European Union quotas gained ground. Meanwhile, the understanding of board diversity expanded to include not just gender and ethnicity but skill sets, cultural background, and diversity of thought – and the business value they could produce.

Analysis of board appointments during the period suggests a complex interplay between aversion to risk, likely heightened by economic turbulence, and an as-yet incomplete commitment to diversity. From the standpoint of gender and ethnicity, some hopeful signs appeared. The percentage of women among newly appointed directors climbed steadily each year from 2009 through 2013. The percentage of African-Americans among new appointees in 2013 was nearly double the figure for 2009. On the other hand, those percentage increases occurred on a very small base. Further, sitting and former CEOs and sitting and former CFOs together claimed almost two-thirds of new appointments throughout the five-year period. While that preponderance of CEO and CFO appointments inadvertently limited demographic diversity, the more important point is that it suggests a reluctance to embrace candidates who do not fit the CEO / CFO mold – candidates who could potentially make equally valuable contributions to board deliberations.

Key trends

Since 2009, the ***Board Monitor*** has tracked data on new appointments to Fortune 500 boards by gender, ethnicity, age, and CEO / CFO experience. In 2011, it was expanded to include several additional data points, including the seating of international candidates, individuals who had previous board experience, and new appointees with government or career military backgrounds. In 2013, CIO experience was added to the attributes to be tracked. From an analysis of this data, there emerged the following key trends in board appointments.

Average figures for newly appointed directors over the last 5 years (2009–2013)

326 NEW DIRECTORS (PER-YEAR)

57 AGE OF DIRECTORS

22% FEMALE

5% HISPANIC

7% AFRICAN AMERICAN

5% ASIAN

23%/3% CURRENT CEOs / CFOs

26%/14% FORMER CEOs / CFOs

11% RETIRED GOVERNMENT

215 PREVIOUS BOARD EXPERIENCE (PER-YEAR)

Turnover among board members has remained stable – and low – throughout the past five years

YEAR	BOARD SEATS	TURNOVER
2009	**5300**	6.7%
2010	**5140**	5.4%
2011	**5260**	6.4%
2012	**5319**	5.6%
2013	**5249**	6.8%
AVERAGE	**5254**	6.2%

From 2009 through 2013, the number of newly appointed directors of Fortune 500 companies averaged 326 per-year, with a turnover rate that ranged from 5.4% to 6.8%. Low turnover, resulting partly from few boards employing tenure-limiting mechanisms, constricts the number of opportunities to create more diverse boards.

The average age of newly appointed directors remained virtually unchanged from year to year

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Average age	**57**	■ **57**	■ **57**	▲ **57.5**	▲ **58**	**57**

While the average age of newly appointed directors remained flat, a small but interesting uptick in the appointment of young directors (under 40) has occurred. We will "watch this space" to see if that gradually impacts average director age.

From 2009 through 2013, sitting or former CEOs accounted for almost half of newly appointed directors

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Sitting CEO	**78**	▼ **62**	▲ **74**	▼ **71**	▲ **83**	**74**
	21.9%	22.2%	22.0%	23.8%	23.1%	22.6%
Former CEO	**93**	▼ **76**	▼ **70**	▲ **77**	▲ **114**	**86**
	26.1%	27.2%	20.8%	25.8%	31.8%	26.4%

During that five-year period, sitting CEOs accounted on average for almost 23% of newly appointed directors and former CEOs for a little over 26%, for a combined total of almost half. In absolute numbers, 798 of the 1,628 directors appointed from 2009-2013 were sitting or former CEOs at the time of their appointment.

"One of the biggest obstacles to diversity is the prevailing notion that the ideal director must have CEO experience"

Sitting or former CFOs accounted for about 17% of newly appointed directors

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Sitting CFO	**10**	▼ **9**	▲ **17**	▼ **6**	▲ **9**	**10**
	2.8%	3.2%	5.1%	2.0%	2.5%	3.1%
Former CFO	**70**	▼ **39**	▼ **34**	▲ **43**	■ **43**	**46**
	19.7%	14.0%	10.1%	14.4%	12.0%	14.1%

That figure, combined with the figure of more than 50% for sitting and former CEOs, brings to two-thirds the percentage of new appointees during the period with CEO or CFO experience.

In absolute terms, 280 of the 1,628 directors appointed from 2009 through 2013 were sitting or former CFOs. Not surprisingly, the combined demand for former and sitting CFOs reached its highest level in 2009 following the worldwide economic meltdown, leveling off thereafter.

From 2009 through 2013, the percentage of newly appointed women directors increased somewhat each year

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Female	**64**	▼ **54**	▲ **73**	▼ **68**	▲ **93**	**70**
	18.0%	19.4%	21.7%	22.8%	25.9%	21.6%

The consistent increase from year to year suggests that women are steadily gaining ground in the boardroom and should continue to do so in the future. What is unknown is how many of those appointments represented women replacing women – which would leave the overall percentage of women on Fortune 500 boards unchanged.

In 2013, the percentage of African-Americans among newly appointed directors was nearly double the figure from 2009

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
African-American	**19**	▼ **9**	▲ **26**	▼ **23**	▲ **37**	**23**
	5.3%	3.2%	7.7%	7.7%	10.3%	7.0%

African-Americans constituted a little more than 10% of new directors in 2013 versus a little more than 5% in 2009, and more than triple the low for the five-year period of a little more than 3% in 2010.

The percentage of Hispanics among new directors remained relatively flat throughout the period

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Hispanic	**18**	▼ **15**	▲ **13**	▼ **14**	▲ **18**	**16**
	5.1%	5.4%	3.9%	4.7%	5.0%	4.8%

The percentage of newly appointed Hispanics averaged a little under 5% and deviated little from the average during the past five years.

The percentage of newly appointed directors of Asian origin or heritage fluctuated from a high of 8% in 2011 to a low of a little over 3% in 2012

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Asian	**14**	■ **14**	▲ **27**	▼ **10**	▲ **22**	**17**
	3.9%	5.0%	8.0%	3.4%	6.1%	5.3%

Despite the fluctuation in the number of newly appointed Asian board members over the past three years, they are in high demand as the region continues to be an indispensable part of the global economy. Fluctuations in the numbers could be attributed to the scarcity of board talent at this time, a situation that is likely to change as more Asian companies become global enterprises. In addition, we may see more female Asian executives joining boards.

Individuals with government or career military backgrounds constituted, on average, 11% of new appointees for the past three years

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Retired Government	–	–	**35**	▼ **27**	▲ **45**	**36**
	–	–	10.4%	9.1%	12.5%	11.0%

Though no clear trend has emerged since we began tracking this in 2011, last year's figure of more than 12% – the highest to date – and our recent board search work suggest that demand for directors with government or career military experience is rising.

For the past three years, almost two-thirds of new appointees came with previous board experience

	2009	2010	2011	2012	2013	Average
Number of new directors	**356**	▼ **279**	▲ **336**	▼ **298**	▲ **359**	**326**
Previous experience	–	–	**229**	▼ **199**	▲ **216**	**215**
	–	–	68.0%	66.7%	60.2%	65.9%

Since we began tracking this data in 2011, 644 – or about 65% – of the 993 new appointees had previously served or were serving as corporate directors. During that three-year period, the percentage has decreased slightly each year, dropping to just over 60% in 2013. This more recent trend could mean that boards are willing to embrace new directors, from different backgrounds, who add to the overall diversity of their boards.

The way forward

While these five-year trends suggest modest increases in board diversity in a few areas, the overall picture remains largely static. Clearly, for many boards, the ideal director is still a current or former CEO; low turnover means few opportunities for broadening the board's skills and overall composition; and diversity remains a challenge, despite its business value, the near constant media coverage of the issue, and the desire of boards to enhance this area. Given our fitful economic recovery, it is tough to tell yet whether these trends are a factor of the recession (and risk aversion) or an ongoing trend.

Meanwhile, there are a number of things that forward thinking boards can do to add diversity of all kinds. Broadly, this can include appointing directors who have experience with different markets, customers, geographies, or functional areas that are crucial to the company's strategy, as well as fresh perspectives and new ideas. So, what to do?

Rethink default settings

One of the biggest obstacles to diversity is the prevailing notion – the default setting, in effect, on many boards – that the ideal director must have CEO experience. Certainly, many skill sets converge in a typical CEO, and an experienced chief executive can add great value to the board's work and provide useful advice to management. However, many outstanding GMs and divisional heads possess the strategic and operational skills, as well as the P&L experience, that make CEOs such attractive board candidates. In addition, presidents of universities, retired public servants who have led large government agencies, and retired career military officers can also bring qualities of executive leadership and experience that boards value. Many former public servants and retired military officers have worked in contexts that require delicate diplomacy, strategic thinking, the balancing of competing interests, and the ability to deal with seemingly intractable problems. And many have attained what observers see as the most desirable personal characteristics for board service – wisdom and battle scars.

Consider top functional leaders

As the *Board Monitor* affirms, the financial expertise of CFOs has long been valued, but many boards have been otherwise reluctant to bring on executives with strictly functional depth rather than broad general management experience. However, those boards should consider how a director whose functional experience is relevant to a key area of the company's strategy can add great value. For example, in industries where customer privacy, network security, and business recovery are critical, the board should have sufficient expertise to exercise oversight of cyber risk – expertise a CIO might provide. Companies in formerly heavily-regulated industries facing unfamiliar marketing challenges may want CMOs to provide a customer-centric perspective to board deliberations. General Counsels with deep M&A expertise can be valuable when a company is growing rapidly through acquisition or is in a heavily regulated sector. The challenge in taking on functional experts lies in finding the right balance: functional depth has to be combined with a breadth of perspective. Have they attended all of their company's board meetings? Do they serve as part of the strategic brain trust at their company? Is intellectual curiosity part of their DNA? Such candidates for board seats are in fact out there, and they offer yet another opportunity to multiply perspectives in the boardroom.

Catch a rising star

By searching diligently, boards may also find younger executives on the fast track to the top, a group that is generally more diverse than in the past and that will furnish many of tomorrow's CEOs. Large US-based companies known for best practices in talent development are a good place to start. But because boards are likely to look to these kinds of high-profile companies first, the competition for those who are genuinely qualified for board service could be fierce. However, there are many, less well known but equally impressive businesses with up and coming general managers on the CEO or similar track who can and should be considered for boards.

Don't rule out well-run private companies

Traditionally, many boards have been unwilling to look to private companies for board candidates. Rightly or wrongly, directors regarded private companies as having different priorities from a public company and perhaps not generating the scale and scope of experiences required for service on the board of a large, publicly-traded company. However, the surge in private equity investment and the recruitment of strong public company trained leaders to the private company sector has changed the environment. In fact, many outstanding public company executives have migrated to private companies. Further, there are some dynamic private companies that are also adept at developing leadership skills and that follow public company governance models. They mirror their public counterparts in many ways.

Insist on diverse slates of candidates

The full board can require that the Nominating Committee and its search firm, if one is engaged, present diverse slates of candidates for director openings. The board can also review the criteria for new board members, considering not only diversity of gender and ethnicity, but also of geography, skill sets, industry background, and other experiences. This should enable the board to look beyond CEOs and "well-rounded" directors for candidates with specific skills who can contribute directly to the strategic needs of the business.

Boards and their nominating committees should not let the perception of risk discourage them from taking these steps and considering non-traditional candidates. In fact, a great deal of risk lies in not diversifying today's boards. With a disciplined search process, a determined nominating committee, and an experienced executive search firm, creating a more diverse board does not have to entail risk. Sourcing and assessing qualified candidates does, however, require a degree of extra effort. The Nominating Committee may need to look beyond the traditional pools of talent, add the question of readiness to assessment, and reference more extensively the farther they depart from traditional candidates. And they will need to be well prepared to defend any choice that other directors might regard as risky. But none of those steps is particularly difficult; they require only the will to undertake them and due diligence in carrying them out. And in the long run, the extra effort will deliver far more value to the board and the company than will simply proceeding at the unnecessarily slow pace of the past five years.

During the next five years of *Board Monitor*, we will continue to report on these critical demographic trends – and what lessons we can all take away from them and bring back to the boardroom.

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201401JNTSRG114