Board Composition

Refreshing the Board

By Steven B. Stokdyk, Joel H. Trotter, and Catherine Bellah Keller

Recent press coverage and updated proxy voting guidelines suggest that board refreshment is a topic on fire. It's a subject that inspires strong feelings and competing perspectives on director tenure or board diversity—or both. Yet these incendiary dialogues scarcely help a board in considering what is best for the company and shareholders. We suggest boards step back and review their composition in light of the company's goals and needs in three areas.

1. Board self-assessments. As part of their regular self-assessment process, public company boards should consider their composition and the unique contributions of each current or prospective director. For example, boards may try to recruit directors with specialized experience, such as in technology or international operations, as well as directors whose experience is not represented or is underrepresented on the board. Indeed, Securities and Exchange Commission regulations require companies to disclose diversity considerations in the director nomination process. Mixing new and longer-tenured directors with different skill sets may add valuable perspectives and knowledge to a board.

2. Succession planning. Increases in director turnover have made succession planning a vitally important board concern. The average age of independent directors has risen over the last decade, and retirement and resignation have become key drivers of recent or pending changes in board composition. Tenure limits, voluntary retirements, and the inability to effectively manage multiple board commitments—i.e., overboarding—are the most common causes of turnover. Turnover also results when companies implement mandatory retirement policies. Strategically focusing on board composition in advance can aid in weathering turnover situations, which provide an opportunity to refresh the board with much-needed—and desired—experience.

3. Shareholder engagement. Maintaining dialogues with large institutional investors, activist investors, and proxy advisory firms has become imperative for many companies. Activist and institutional shareholders often focus on introducing new perspectives and experiences in the boardroom, with the corresponding view that tenure beyond a certain number of years leads to entrenchment, compromised independence, and insufficient growth. On the other hand, tenure can create valuable institutional knowledge as well as a higher likelihood that these directors will challenge management should the need arise. When communicating with investors on these issues, boards may find it productive to emphasize the value of the company's directors and their process for reviewing both long-standing and prospective directors.

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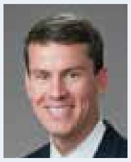
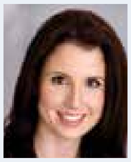
Large institutional investors and proxy advisory firms are also very focused on corporate governance and board issues. They tend to disfavor rigid tenure or age limits while often opposing longer-tenured directors, particularly as they examine independence and succession planning issues. These investors also tend to focus more on diversity and gender. A recent study reports a steadily increasing number of boards with at least one female director, with companies primarily increasing board size to add a female director. Individual states are also getting more involved, either legislatively or through their large pension funds. For example, California recently passed a resolution to encourage its public companies to include a minimum number of female directors, and its pension funds are active in this area for the companies they invest in as well. These constituents also consider the annual board self-evaluation to be critical, and often want to discuss the board's bases for composition decisions.

In all of these areas, a board should develop a carefully considered understanding of their composition and needs, reflecting the board members' unique perspectives and concerns, to facilitate engagement with a company's multiple constituencies and stakeholders, and to proceed both effectively and in the best interests of the company and its shareholders.

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