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NYSE Governance Services

Making a Great Board

RHR International

What makes a board great? In his recent *Forbes* blog, entrepreneur Bryan Stolle, a former CEO and software company founder, suggests that a great board is the result of great board members—those who exhibit sound judgment and provide relevant context; offer wisdom, motivation, interest, and a compatible style; are effective coaches and mentors; and have the courage of their convictions. But some new research suggests that a great board is the result of much more than that.

While it's clear the directors themselves are important, there are meaningful intangibles to consider: frankness among board members, the quality of discussion and diversity of opinion, group and self-evaluation, and the presence of strong leadership via CEO succession and board refreshment plans, to name a few. Following this line of thought, RHR International and NYSE Governance Services, Corporate Board Member recently compiled the opinions of nearly 300 board members to find out what directors believe are the crucial elements for making and maintaining a strong board.

Four keys to success: dialogue, diversity, evaluation, and succession

Based on the results of our survey, we were able to establish the following keys to boardroom success:

Quality dialogue.

The quality of boardroom dialogue and debate—followed by the ability to ask tough questions of management and diversity of thought and experience among members—was the most frequent answer given (88%) when the directors we surveyed were asked to name the most significant contributors to board effectiveness. Conversely, a lack of candor in the boardroom (77%) and a lack of mutual respect and a collaborative culture (68%) were the lead answers given when directors were asked to name the factors most likely to undermine board effectiveness (Figure 1).

Along these lines, a recent report from a KPMG audit conference held earlier this year notes that "best practices often focus on process, when substance and substantial thinking and dialogue are really the key."

Accordingly, several directors hit on communication when asked to describe what differentiates a great board from an average board. As one director said succinctly, a successful board is "engaged, communicative, collaborative, candid, knowledgeable [and] takes its responsibilities seriously."

"If you look at the composition of the boards of many of the top financial services companies before the 2008 swoon, they were often composed of a 'who's who' of highly accomplished business leaders. Yet, the whole in many cases was less than the sum of the parts. The way board members operate together, not who they are, is what differentiates a great board from an average one," offers Dr. Paul Winum, RHR's global practice leader for Board and CEO Services and the study's principal author.

Diversity among members.

As noted above, diversity of thought and experience among members was one of the top three responses given when naming important attributes to board effectiveness. More than 60% of the directors we surveyed say diversity is a key factor, and 86% agree that a proactive approach to board

Figure 1

Top factors that most contribute to the making of a great board

diversity is a necessary building block of a great board.

In summing up crucial board components, several directors reflected on the need for diverse backgrounds. One director pointed to the importance of "diversity of experience by directors who are actively engaged within the proper role of the board to provide oversight and perspective."

Mike Myatt, a leadership adviser to Fortune 500 boards and CEOs and a *Forbes* contributor who says he writes about leadership myths and "busts them one by one," offers 10 reasons why diversity is good for the boardroom. They include the fact that diversity reflects the real world and your customer base, leads to healthy debate and a necessary disruption of the status quo, and makes the company adaptable to an ever-changing environment. Myatt boils it down to one simple truth: "Board diversity is simply smart business."

Meanwhile, numerous governance experts and think tanks have expounded on the need for gender and racial diversity, with little success. A recent *New Republic* article title touts the need to fix the "Very Pale, Very Male Boardroom," citing still stagnant numbers in terms of the number of women executives and directors and people of color running Fortune 500 companies.

"Achieving the benefits of a diverse board requires going beyond just a quota approach and looking more deeply into the differing backgrounds and perspectives that result in less group-think and more capacity to consider the range of ideas needed to govern well," adds Winum.

Effective peer and self-evaluations.
In terms of their own evaluations, only 36% of directors rated their most recent experience with a board evaluation as very effective (Figure 2). For those whose experience was less than "very effective," we asked why and most said either the exercise was "all form, no substance" (44%), board members "were not candid" (34%), or the board "did not follow through on the evaluation recommendations" (33%). Further, 48% noted that corporate boards are not good at providing constructive feedback to board members on the quality of their contributions, and 30% said this is true specifically for the board on which they currently sit. So while it sounds like evaluations can be very useful, for many boards, there is much room for improvement.

TK Kerstetter, chairman, NYSE Governance Services, Corporate Board Member, Intercontinental Exchange, says that a meeting to review the findings of board evaluations is critical. "If boards have identified action items or issues they want to correct, failure to implement those changes can have a major impact on how the board is perceived to handle its affairs." Furthermore, Kerstetter adds, directors lose patience with the process if actions they identify as necessary aren't acted on by the chairman.

Dr. Patrick Dailey, a member of RHR's Board and CEO Services practice, acknowledges that there are understandable obstacles that must be overcome for a board and director assessment process to be effective. "Because of the reluctance to criticize fellow directors, the board chair, or the board itself, the process for gathering input and delivering feedback must be done very skillfully for it to be more than a check-the-box exercise."

Managing CEO succession.
When asked to choose from a list of possible actions that could be instrumental in making a great board, 81% of director respondents chose a "regular, ongoing evaluation program for CEO/leadership succession" as the most significant contributor. Many of the directors we surveyed believe their board does a credible job in this area. Sixty-seven percent indicated their board does a very good job managing and evaluating the performance of the CEO; 30% said they do this job at least somewhat well. (Interestingly, when asked about U.S. boards overall, these percentages were basically reversed: 33% said boards do this job very well and 59% said they do it somewhat well.) Further, when asked to rate their board's effectiveness at aligning the CEO's performance with board expectations, two-thirds (68%)

Figure 2
How effective was your most recent board evaluation?

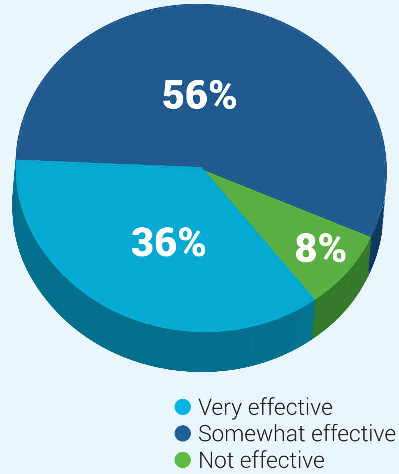
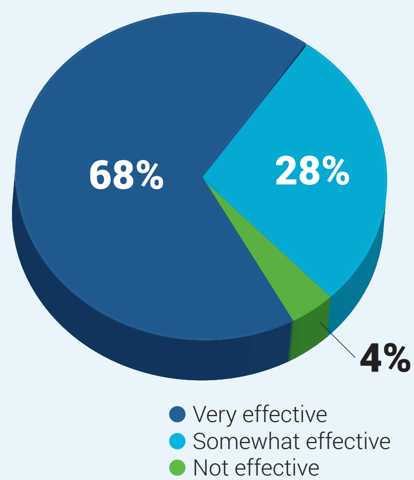


Figure 3
How effective was your last CEO evaluation at aligning the CEO's performance with the board's expectations?



pronounced themselves effective and 28% said they were at least somewhat effective at doing so (Figure 3).

"The good news is more and more directors are appreciating the importance of both CEO evaluations and succession," says Kerstetter. He notes that an effective CEO evaluation program requires leadership on the board's part and is being embraced more than ever before. Therefore, he says, it is important to establish a regular process for evaluating the CEO and discussing both the board's and the CEO's plans for the future. "Recruiting, compensating, cultivating, retaining, and planning for the succession of the CEO has always been one of the core responsibilities of the board, and boards that handle it well typically have a good foundation that allows them to be effective overall."

Other key takeaways

One encouraging note is that 87% of the directors we surveyed confirm that they have had the experience of serving on what they would consider to be a "great board." Most (73%) agree that a great board, compared with an average board, is a substantial contributor to a company's success (Figure 4), though they believe management, not the board, plays the primary role in determining a company's success. Beyond the four keys to success noted above, the directors we surveyed also place significant importance on mandatory equity ownership (49% very significant; 39% somewhat significant) and offsite board retreats (34% very significant; 37% somewhat significant). However, most don't find a mandatory age requirement or third-party facilitated board evaluations significant and are relatively split on the significance of splitting the CEO and chair positions (29% very significant; 33% somewhat significant; and 38% not significant). Further, in terms of important board attributes, they placed low importance on a willingness to engage with shareholders and the ability to leverage business relationships relevant to the company.

As to factors that could limit board effectiveness, a majority (53%) worry about a lack of independence from management, and 43% say ill-prepared directors could undermine success. With regard to the latter, a solid majority (59%) say U.S. boards overall fail to do a good job of replacing directors who are not contributing value; 27% say this is a problem on their board. The effectiveness with which a board renews itself and manages its own succession is a key factor to ensure a healthy and self-sustaining board.

"The bottom line here is the impact that a board has on the performance of the organization it is charged with governing," notes Winum. "With 73% of the directors in this survey saying that a great board adds substantial value to a company's success, directors really have an obligation to their stakeholders to hold themselves to the highest standards of governance."

Figure 4
How much does a great board contribute to a company's success compared to an average board?