Board Improvement Needs to Be a Process, Not a Reaction

By Judy Warner

Boards are at an inflection point. That point was underscored by William E. McCracken, former CEO and executive chair of CA Technologies, at a special event convened by the National Association of Corporate Directors (NACD) to help directors understand the significance and implement the recommendations of the *NACD Blue Ribbon Commission Report on Building the Strategic-Asset Board.* McCracken, who serves on the NACD board, among others, spoke before a rapt audience in New York City. He emphasized the need for boards and individual directors to routinely evaluate themselves to ensure that skill sets align with corporate strategy and that board composition reflects what society looks like.

Each year, NACD assembles a think tank of directors and corporate governance stakeholders to study and make recommendations about a topic of acute importance for boards. The *NACD Blue Ribbon Commission Report on Building the Strategic-Asset Board* was released in October, the twenty-third in the series.

There is a disturbing lack of women and minorities serving on America's corporate boards. With public company board turnover so slow and the correlation between corporate performance and diversity growing stronger, how boards deal with their own development, succession, and refreshment is imperative, according to the BRC.

Robyn Bew (left), Glenn Booraem, and William E. McCracken

Judy Warner (left), Anne Sheehan, and Allan Grafman.

That same day, in Ponte Vedra Beach, Florida, the annual meeting for Wells Fargo & Co. was underway. The question of whether all of the troubled bank's directors would be reelected dominated the chatter between sessions at the NACD forum. (They ultimately were.) What did the Wells Fargo board know about the ethical concerns raised by employees about the company's business practices—specifically those relating to the unauthorized creation of customer accounts in order to meet sales goals—and when did it know it? According to a report of a special investigatory committee of the Wells Fargo board, it knew too little, too late. It was against this backdrop that McCracken asked, "Are boards using their knowledge, their experience, and the benefits they can bring to help position the company for the future and ensure their longevity?"

Moreover, investors and their advisors are exerting greater influence on how boards are evaluated—including institutional and long-term investors such as BlackRock, Vanguard, and the California State Teachers' Retirement System (CalSTRS), the latter two of which were represented at the event.

When BlackRock, the world's largest asset manager, disclosed its 2017–2018 engagement priorities in June, board accountability, effectiveness, and diversity topped the list. With $5.1 trillion in assets under management, BlackRock's clout cannot be understated: it holds a percentage of just about every public company. By issuing these priorities, BlackRock encourages companies to improve their own engagement efforts.

"Board composition, effectiveness, diversity, and accountability remain a top priority" reads the first bullet point on the document,

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which is posted on BlackRock's website. A warning follows that specifically targets nominating or governance committees, which, BlackRock said, would be held accountable "for an apparent lack of commitment to board effectiveness."

BlackRock's head of governance, Michelle A. Edkins, told a Reuters reporter that the firm is looking to better understand how companies are working to increase boardroom diversity, including adding women directors. "A guy from Yale and a guy from Harvard does not count as diversity," she said.

Another asset manager used International Women's Day to urge companies to improve board diversity. State Street Corp. installed the statue called "Fearless Girl" facing the iconic symbol of Wall Street, the bronze charging bull. State Street followed up that installation with a letter to the companies that comprise the Russell 3000 index asking them to take action to increase diversity on their boards.

There is definite room for improvement: State Street says that roughly a quarter of the 3,500 companies it sent letters to do not have a single woman director on their boards.

In addition to gender imbalance, board skill sets need to be evaluated to ensure an alignment with corporate strategy, a point noted by Glenn Booraem, investment stewardship officer at Vanguard and a member of the BRC.

"Refreshment for me always brings to mind something you do to something that you haven't taken good care of, and is really more of an event than a process," Booraem said during a discussion with fellow commissioner McCracken moderated by Robyn Bew, NACD's director of strategic content development.

"We adopted this continuous improvement terminology in the report to position continuous improvement or strategic evolution as an ongoing process that the board undertakes to ensure that its capabilities and its mind-set are aligned with the organization's strategic priorities at each point in time," Booraem explained. "This ongoing cadence of evaluating what the needs of the company are, what the capabilities of the board as a body and the individual directors are, and how those interact in support of long-term value creation, is really the frame here."

In another session, Allan Grafman, an experienced director and frequent writer on governance topics, and Anne Sheehan, director of corporate governance at CalSTRS, shared their views. Grafman, who has served on a number of public and private boards, proposed a novel approach to encourage board renewal: with the average tenure of an S&P 500 director clocking in at a little over eight years, directors should be encouraged to take a sabbatical.

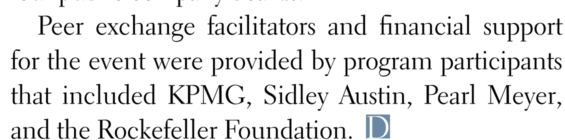
"The number of public companies is half of what it was 20 years ago," Grafman said. "How do you get refreshment? One thought is that you have a refreshment at seven years and it applies to everyone [on your board]."

Grafman reasoned that the benefits of such a sabbatical program would remove the stigma of leaving a board, which he said may be the most significant impediment to board refreshment. "No director wants to be told, 'Your time is up,'" he said. "[So] you take away the stigma."

CalSTRS, manager of one of the country's largest pension funds, is a vocal proponent of good governance practices. Sheehan also served on the BRC. Like Grafman, Sheehan acknowledged that the requirements of and the demands on directors have dramatically increased over the past decade. "We are not going to get more diversity if there isn't more turnover in those board seats," she said. "We want to make sure the companies also are keeping up on what the skill sets are that are needed inside the boardroom to guide the strategic direction of the company."

On its website, CalSTRS lists its best practices for board composition: independent leadership; diversity; a board-specific refreshment and succession plan (because life happens); varying tenures to assure both experience and fresh perspectives; board accountability for meeting attendance and participation; annual elections; and limits on the number of boards a single director can effectively serve. CalSTRS advocates that CEOs serve on no more than one board other than their own and that directors serve on not more than four public company boards.

Peer exchange facilitators and financial support for the event were provided by program participants that included KPMG, Sidley Austin, Pearl Meyer, and the Rockefeller Foundation.



How to Build a Strategic-Asset Board*

- Conduct annual evaluations at the full-board level and evaluations of committees and individual directors at least every two years. Use a qualified, independent third party on a periodic basis to encourage candor and add a neutral perspective.
- Boards should review their governance principles on a regular basis (at least every other year) to ensure they are complete, up to date, and fully understood by current members and director candidates.
- Governance principles should incorporate a definition of director responsibilities, including a commitment to ongoing learning and the belief that service on the board should not be considered a permanent appointment.
- The director recruitment process should have a time horizon that matches the organization's long-term strategy, typically three to five years.

*Recommendations from the *NACD BRC Report on Building a Strategic-Asset Board*