Refreshing the Board of Directors

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Increasingly shareholders, other stakeholders and regulators are seeking greater board turnover and diversity in board composition as the tenure of directors, age limits and term limits increase. Unquestionably, board performance begins with board composition, the character, integrity, competence and skills of those who comprise the corporation's governing body. Selection, oversight, evaluation, compensation, and if necessary, termination of the CEO, equally as important as board composition, depends on the character, fortitude, experience and skills of those who comprise the Board of Directors. Board composition remains one of the most, if not the most, challenging aspects of corporate governance. Below are thoughts respecting tools that boards may use to address board composition and increasing concerns about overly long director tenure.

Board Composition is a Balancing Act; So Few Positions, So Many Needs

As corporate boards have reduced their size from an average of 14 to 16 in past years to 10 to 12 currently, the number of positions available to achieve needed diversity has declined. Simultaneously, the number of critical skill sets needed on boards has increased. Coming out of the financial crisis and facing an environment increasingly impacted by the internet, communications technology, social media, complex financial transactions and products, rising business sustainability concerns, increased reporting obligations with respect to many different categories of data, demands from regulators and stakeholders to materially improve risk recognition, assessment and mitigation skills and increased recognition of the need for better industry experience on boards, as well as the recognition that board performance may suffer from lack of gender, ethnic and age diversity, it's no wonder that board composition and the relevance of the skills and qualifications of those who serve, as well as director tenure, have come under increased scrutiny.

Do We Need to Reverse the Trend Towards Smaller Boards?

The jury is out on this question, but it's a question that needs further thought if we're going to address the needs identified in the prior paragraph. While we all recognize that up to a point, smaller boards may facilitate better board communication, discussion and decision-making, the demands for diversity and for an increasingly varied number of skills on the board may mean that more directors are required to meet the board's many needs. Perhaps we'll see a slight increase in the number of directors on a board from ranges of 10 to 12 to ranges of 12 to 14. Further, we all recognize that board size may well be a matter seriously affected by the complexity of the organization governed. Certainly in smaller less complex businesses, boards of fewer than 10 to 12 directors are common and, in fact, helpful.
Board Culture and Director Expectations

What's needed to facilitate board refreshment is a shift in board culture and director expectations from a culture which assumes continued re-nomination to a culture which understands that each seat should be considered available to meet the needs of the company and the board at the time of re-nomination, placing these needs above any director's desire to continue in his or her role. Directors need to approach the end of each term of service, whether it's one or three years, from a perspective which doesn't assume or expect continued re-nomination, but always with the attitude that if the governance committee or any other body determines his or her seat is required to serve other needs or values of the organization, the director will gladly make that seat available; a collective and individual view that is more servant-oriented, looking always to the organization's best interests and needs and placing those above any individual agenda such as continuing service.

Granted that it takes a year or two, sometimes more, for a director to understand critical aspects of the organization to reach a high level of effectiveness, and granted that some degree of continuity is important to an effective, high performing board, and that in some instances a particular individual may be elected for many years for very specific, important reasons, such continuity should be the exception not the norm. While fewer than five or six years of service on a particular board will be the exception rather than the norm, boards need to develop a culture in which a director's attitude is that his or her seat is always available if the committee is considering re-nominations, or the board determines that it needs the seat to better serve the current needs and best interests of the organization. A relatively brief period of service for a director, in today's terms, should be no sign of dishonor or lack of value on the part of the director whose seat is needed. We all know that companies' situations will evolve over time and may change very quickly. Board composition needs to be very responsive to the changing needs of the organization however rapid or long-term.

The board culture regarding board refreshment, and director expectations regarding continuity of service, can and should be reflected in a company's principles of governance and written director qualifications. A culture of board refreshment and the expectations of the board regarding a candidate's understanding of and attitude towards this subject can and should be underscored during the director search and recruitment process. The culture and expectations can be further underscored in the invitation to a particular candidate to join the board, and reinforced during a thoughtful board and director evaluation in connection with director re-nomination process.

Principles of Governance

Most public companies, private companies and nonprofit organizations now publish principles of governance which take into consideration many factors regarding a company's governance, including director term and age limits, board and director evaluations, board organization and leadership, board composition, etc. The principles would be an excellent place to articulate the board's view regarding refreshment, director continuity and tenure. The principles could articulate the importance of directors having a “servant” mentality regarding the availability of their board seat to serve the values and evolving needs of the enterprise, always placing the best interests of the corporation above their individual desire to continue serving as a director.

For example, at a given time the board may determine that it needs an individual capable of assuming, on an interim basis, a senior management leadership role (Chair/CEO, CFO) or a board leadership role (independent chair in a situation where the board has determined to separate the Chair/CEO roles, or lead director in a situation where the
board has not had a lead director or determines the immediate need for another lead director). Further, crises may occur, or opportunities may arise with respect to which the board may not have directors with the special expertise and experience required. Boards need the flexibility to be responsive to these and many other situations. The principles of governance can be a place where factors regarding board refreshment and the needs for seats to respond to particular challenges can be articulated.

**Director Qualifications**

Written director qualifications, revised as organizational needs occur or evolve, available at the time of re-nomination consideration, search and recruitment efforts and board and director evaluation provide an opportunity to articulate the importance of board refreshment and the expectations of directors regarding the availability of their board seats at the time of re-nomination. Age limits and term limits must be carefully implemented and not become a substitute for rigorous evaluations in order to avoid the unintended consequence of retaining directors longer on boards than might otherwise be merited, a practice which works against a culture of continual board refreshment.

In considering director qualifications, it is important to recognize personal characteristics in addition to professional accomplishments. Critical to board performance is the ability of board members to function effectively in a peer-oriented environment. Critical to board leadership are directors with personal qualities, experience and skills to effectively serve as independent chairs and lead directors. These positions are not positions which can be filled by any person serving as a director, they require special skills, personal qualities and experience.

**Director Searches, Recruitment and the Invitation to Serve**

Again, values reflected in the principles of governance and written director qualifications will be extremely important to the search for director candidates, the recruitment of a particular candidate and the extension of an invitation to the candidate to serve on the board. These processes offer an excellent opportunity to articulate the board’s values respecting board refreshment, and the expectations of those invited to serve. In fact, a good search and recruitment process will use the values articulated in the principles of governance and director qualifications to screen candidates for those whose values, experience and personal qualities align with the board’s refreshment culture.

**Board and Director Needs Assessments and Evaluations**

Many boards now create matrices reflecting their view of the director skill sets and characteristics needed to assist the board’s effective performance of its responsibilities. These assessments offer an opportunity to highlight needs which can be filled only through increasing the number of directors or replacing one or more existing directors. Rigorous evaluations of board and director performance offer opportunities to replace directors whose performance has lagged or whose skill sets are no longer a priority for board composition. It would help board refreshment considerably if directors recognized the importance of other skill sets and more frequently offered their seats in recognition of the needs of the corporation and the board.

**Director Agreements, Board Charters and Director Job Descriptions Including Continuity and Tenure**

Many companies have agreements with directors, or board charters and/or director job descriptions, which focus on director protection (indemnification, advancement of expenses, D&O insurance, etc.), instances requiring a director to
submit his/her resignation (e.g., change of job, conflict of interest, criminal misconduct, etc.). These agreements, charters, job descriptions could be expanded to include percentage of negative shareholder votes, failure to meet a broadened list of qualifications and the like. These documents could include provisions respecting the importance of board refreshment, continuity and tenure to set director expectations and facilitate a culture which recognizes the importance of regular board refreshment and voluntary director conduct respecting the creation of board vacancies in service of the board's needs.

Requests for Voluntary Resignation

Following an evaluation of board needs, director performance and director skill sets, or the occurrence of director conduct which is problematic for the board’s functioning or reputation, boards could more often seek the voluntary resignation of a director, and, worst case, use other tactics to obtain a director’s resignation.

Director Orientation and Education

Director orientation offers a board an excellent opportunity to emphasize various board values such as the importance of board refreshment, and expectations, from the day a director’s service begins. Continuing director education offers an opportunity to reinforce those values.

Takeaway

Those who are interested in corporate governance have begun to recognize that lengthy director terms may not serve the best interests of corporations or their stakeholders. Yet the push for director term limits may create an artificial and misguided proxy for monitoring board composition and tenure. A philosophy of board refreshment, along with policies and procedures that reinforce that philosophy among directors and a willingness by directors to critically evaluate, on a regular basis, the contributions that they and others are making or could be making to the board, are the more effective means to ensure a well-functioning and diverse board, comprised of directors who meet the corporation’s evolving needs.


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