IN TOUCH WITH THE BOARD

One in a series of communications from the Russell Reynolds Associates' CEO/Board Services Practice, ***In Touch with the Board*** addresses best practices in board composition, assessment, succession planning and other critical corporate governance issues.

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Board Composition: Turning a Complex Issue into a Strategic Asset

In this issue, Russell Reynolds Associates' European CEO/Board Services team reviews the numerous factors affecting the composition of European supervisory boards and offers a model of director attributes to guide boards in refining their composition strategy.

"You want to be able to look around the boardroom table and see the different stakeholders represented so that when an issue comes up that involves one of them, you have an experienced person to turn to on that matter."

—Michael Treschow, Chairman of Ericsson and Unilever

European supervisory boards are significantly rethinking how best to fulfil their responsibilities in a time of economic turbulence, changing markets and accelerating globalisation. A good part of the discussion focuses on the issue of supervisory board composition and the qualities to be sought in individual directors and on the board as a whole.

Historically, boards were often very homogeneous institutions, composed largely of men from the same country. Relevant industry expertise frequently was seen as less important than a reputation for collegiality. Extended tenure and extensive board interlocks were not uncommon.

Today, the situation is in flux, with European boards displaying a great deal of variation on the questions of gender, nationality and professional background. Shareholders, regulators and boards themselves are questioning the assumptions that have shaped board composition; there is no one view of what the ideal board should look like. Instead, nominating committees have to balance a number of opposing considerations:

- **Continuity vs. fresh perspective.** Against the background of the global economic downturn, there is a desire to recruit directors with fresh perspectives as well as experience and competencies suited to the challenges at hand. In addition, there is growing appreciation of the fact that boards composed of members with varying perspectives are more likely to ask the important questions rather than succumbing to "group think". At the same time, however, boards want to preserve and leverage their existing institutional knowledge and relationships.

- **Cohesion vs. diversity.** Because of their collaborative nature, supervisory boards, particularly at older companies, often have placed a premium on selecting directors who fit easily into the existing boardroom culture. As a result, CEOs, chairmen and nominating committees frequently turned toward their own professional and social networks when looking for director candidates, reinforcing boardroom homogeneity. Increasingly, however, there is recognition that boards composed entirely of men from the company's home country are at a disadvantage in a world of two genders and of global markets and supply chains. The issue for boards is to incorporate diverse perspectives while maintaining the cohesion and trust that are essential for the board to function properly.

- **Granular expertise vs. big-picture oversight.** Historically, supervisory boards have placed less emphasis on directors having industry-specific competencies. After all, it was the job of the executive board to manage the enterprise; the supervisory board's mission was to provide the oversight that comes from experienced, but more general, business judgement.

  Oversight is still the supervisory board's responsibility. But the complexities of today's business issues increasingly demand that supervisory directors have the appropriate expertise to engage their executive counterparts in substantive discussion and provide meaningful counsel to the CEO.

- **Corporate governance vs. corporate growth.** The events leading up to the current economic crisis have led to calls for supervisory boards to take a more proactive role in risk mitigation. This need is undeniable (and is a continuation of similar measures taken in the wake of the Enron scandal). At the same time, however, there is a growing sentiment that supervisory boards need to plan beyond the current environment and devote substantial focus to ensuring that the executive board is maximising value creation. This requires directors who themselves have extensive track records in driving corporate growth.

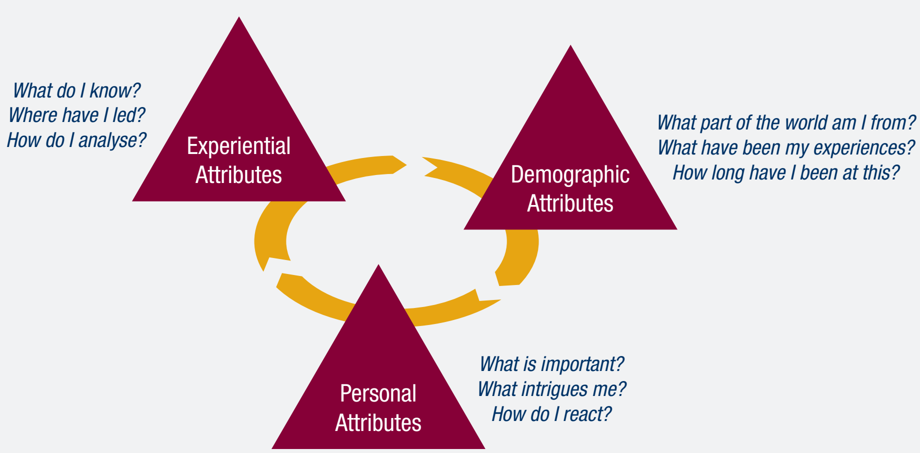
Balancing each of these considerations is not a question of "either/or" but "both". The challenge for each nominating committee is finding the right proportion of the various attributes to be represented and translating that into a strategy that drives its board member appointments.

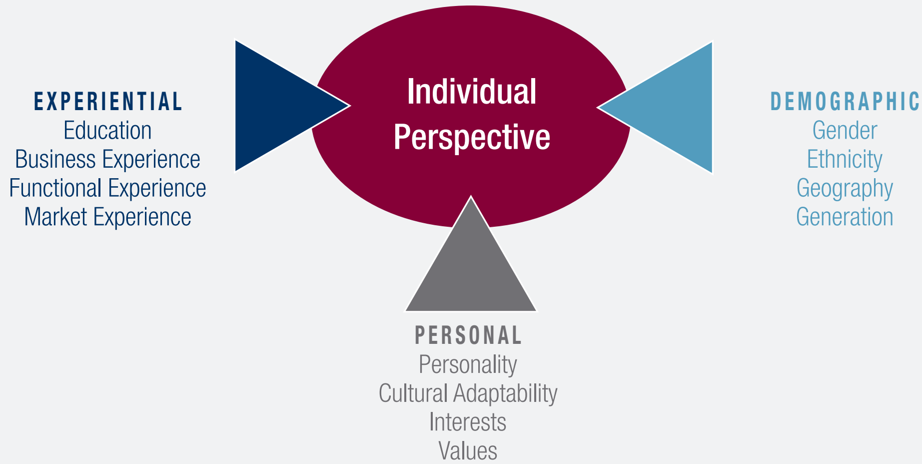
A New Model of Director Attributes

The number of qualities to be considered when managing board composition complicates the identification of director candidates. To help boards in this process, Russell Reynolds Associates has developed a multidimensional model that outlines the range of attributes that interact with each other to form a director's overall perspective:

- **Experiential attributes**, such as education, industry experience, functional experience and accomplishments
- **Demographic attributes**, including gender, ethnicity, geography and generation
- **Personal attributes**, including personality, cultural adaptability, interests and values

These attributes combine to influence the perspectives that people draw upon and the lens through which they





approach the world. These perspectives, in turn, shape the competencies an executive develops, the priorities that guide his or her work, and the insights that he or she generates in solving problems, identifying opportunities and assessing risks.

This multidimensional model provides a starting point that allows nominating committees to more consciously shape and optimise the collective skills and dynamics of the board by identifying the full range of variables to be considered. Analysis of these variables should be included in the candidate assessment process through interviews, referencing, psychometric analyses and other techniques.

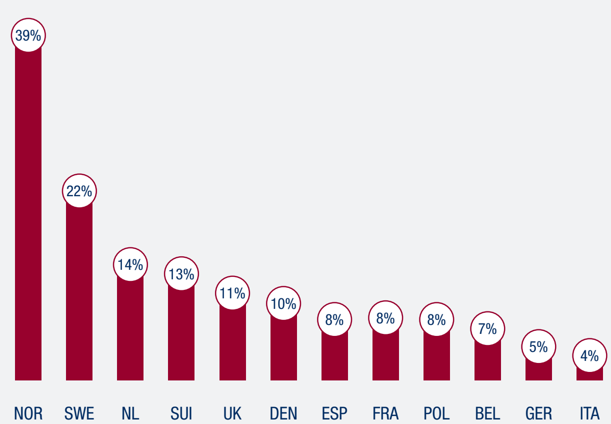
Assessing the Current Situation

While each board handles composition in its own way, it is possible to look at certain variables in the aggregate to get a sharper picture of how change is unfolding at the largest publicly traded companies in each country[1].

- **Gender.** Gender has been the most vocal component in the discussion over diversity in board composition. Across Europe, companies have responded in very different ways. Thirty-nine percent of the directors of Norway's largest companies are now women, following recent legislation there requiring each gender to have at least 40 percent representation on the boards of most large companies. Many other countries, however, such as France, Germany and Spain are in the 5 percent to 10 percent range.

Historically, companies have responded to the issue of gender imbalance by pointing to a lack of women executives with C-level experience from which to draw. Here, Norway's example is instructive. Forced by legislation to recruit women to their boards, Norwegian companies cast a wider net, recruiting from the pool of women just below the traditional top tier and also looking beyond Norway itself, thus increasing international representation. Casting a

PERCENTAGE OF SUPERVISORY BOARD MEMBERS WHO ARE WOMEN



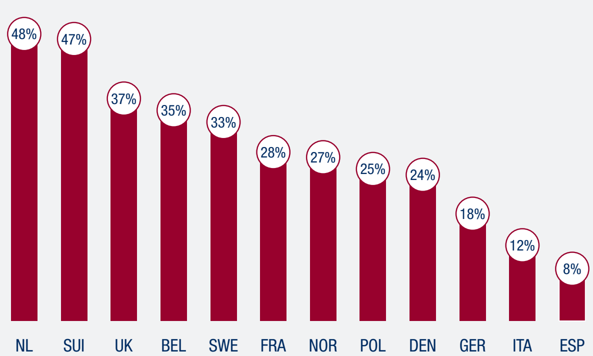
[1] *Statistics in this survey are based on supervisory board members (excluding employee representatives) for those companies listed on each country's primary large-company stock index: FTSE 100 (United Kingdom), DAX 30 (Germany), CAC 40 (France), MIB 30 (Italy), IBEX 35 (Spain), AEX 25 (the Netherlands), BEL 20 (Belgium), SMI 20 (Switzerland), OMX Stockholm 20 (Sweden), OBX 20 (Norway). OMX Copenhagen 20 (Denmark) and WIG 20 (Poland). Statistics are from BoardEx and company Web sites as of 1 March 2009.*

wider net, however, has placed an even greater emphasis on the rigorous and objective evaluation of the prospective director's capabilities to ensure that he or she will be able to contribute at the required level—particularly when it comes to the central board responsibility of evaluating management. There is significant debate within the European business community regarding whether or not some women executives in Norway have found themselves in a board member's seat prematurely, doing a disservice to both the individual and the company.

- **Nationality.** While barriers to globalised markets have fallen dramatically over the last 20 years, boards have been slower to draw their directors from outside the company's home country. There are several reasons for this. To begin with, in many countries, there has been a sense that its flagship enterprises are part of the country's cultural patrimony, something that is reflected in a board composed of the business leaders of that country. But that attitude is softening in the face of globalisation. For example, the boards of Denmark's largest companies, which a few years ago had little foreign representation, now have foreign representation of nearly 25 percent.

At the same time, however, linguistic and logistical barriers remain. Globalising the board usually means conducting board business in a second language, something with which all directors may not be comfortable, particularly on boards with significant

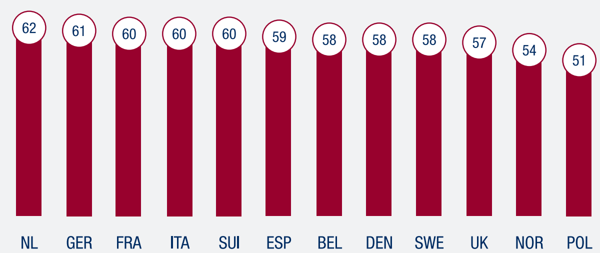
PERCENTAGE OF SUPERVISORY BOARD MEMBERS
OF FOREIGN NATIONALITY



employee representation. More important, while directors from the Americas or Asia may be able to attend regularly scheduled board meetings, they might find it difficult to fully participate in the ad hoc events and gatherings that inevitably occur. A board thus risks dividing itself into "inner" and "outer" subgroups—not a recipe for building a cohesive board.

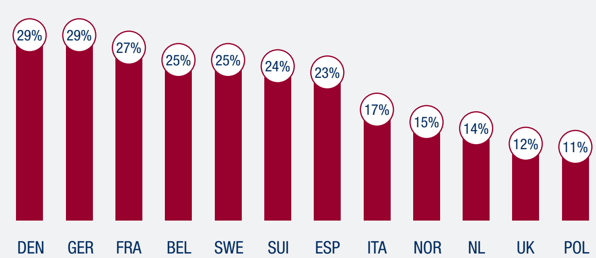
- **Age and Tenure.** The national averages of director age are remarkably consistent from country to country, with the majority falling between 57 and 62 years.

AVERAGE AGE OF SUPERVISORY BOARD MEMBERS



More telling, however, is the percentage of directors who have served on their boards for more than nine years—the outer limit of what is recommended by the United Kingdom's Combined Code of Corporate Governance in the interest of a "planned and progressive refreshing of the board". In a significant number of countries, roughly one-quarter of board members are past this benchmark,

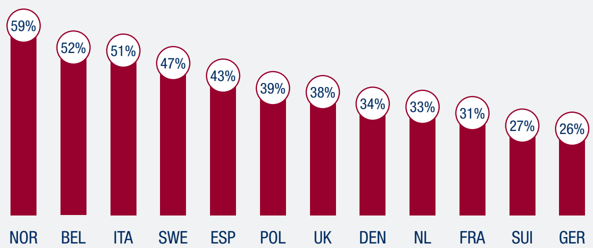
PERCENTAGE OF SUPERVISORY BOARD MEMBERS
WITH MORE THAN NINE YEARS TENURE ON THE BOARD



suggesting that the issue of boardroom succession planning still requires closer examination.

- **Industry experience[2].** Until fairly recently, nominating committees tended to place the greatest priority on recruiting board members with successful CEO experience, irrespective of the industry from which they came. Today, however, there is an increased premium placed on having industry-specific experience in the boardroom, as supervisory and executive boards look to engage each other in more substantial discussions regarding business issues. This does not necessarily mean, however, that the supervisory board should replicate the technical competencies found on the executive team. As well as appointing board members from the same industry, a potential strategy is to add executives from adjacent industries. A retailer might add a board member from the consumer packaged goods sector; a telecommunications company might look for a director from retail, providing a range of relevant perspectives from which the board can engage management on issues of strategy and operations.

PERCENTAGE OF SUPERVISORY BOARD MEMBERS WITH RELEVANT INDUSTRY EXPERIENCE FOR CURRENT BOARD POSITION[2]



Implications for Boards

Aligning a board's composition with the challenges and opportunities it faces in a rapidly changing, globalised world—and then building that group into a cohesive unit—requires a sustained effort by the board, its nominating committee and its chair.[3] The following practices are particularly critical:

- **Nominating committees must approach board composition strategically.** Beginning with the direction of the company and the issues it is facing (both now and five years from now), nominating committees must identify the attributes needed to address those issues in the boardroom. Next, the committee must assess the current board and its attributes against what is required to identify gaps to be addressed. This analysis should include the industry and functional competencies of the board and should evaluate whether or not they are adequate to fully engage the management team.

- **Use a rigorous candidate search and evaluation process.** Guided by the above requirements, boards must continue to move beyond personal, tight-knit networks when looking for directors. A rigorous candidate interview and evaluation process focusing on core competencies is essential to ensure that while directors may have different perspectives and backgrounds, they share the ability to perform at the level required. In addition to the competencies dictated by the board's specific needs, the nominating committee must screen for competencies needed to succeed in a diverse environment, such as cultural astuteness and communication skills.

- **Place greater emphasis on the board's processes and role of the chairman.** Having a more diverse board means expending extra effort to build the group into a cohesive unit. The responsibility for doing so rests with the board chair and the

[2] *Supervisory board members were counted as having relevant industry experience if they currently or previously have held an executive director position in an industry in which the company on whose board they sit operates.*

[3] *For more on this topic, see "What Makes for a High-Performing Board," Russell Reynolds Associates* In Touch with the Board *Series, Issue 2, 2008.*

choices he or she makes regarding committee assignments, board policies and board culture. A well-thought out onboarding programme, as well as ongoing, detailed education regarding company operations, is critical. Details such as how many site visits a board should conduct each year and how often the board gathers for dinners and other opportunities for social interaction take on greater importance with a more diverse board.

- **Make board assessment a priority.** Board processes should include a rigorous, annual assessment of both the collective board and individual directors. Forward-thinking boards have external consultants conduct the assessments every three years to ensure objectivity and the use of best practices. Such assessment creates the shared standards and expectations that transform the board into a high-performing organisation.

Conclusion

Board composition will continue to be a defining issue for European companies as they look to engage with their management teams on a more substantial level, reflect the perspectives and concerns of their global shareholders and stakeholders, and act as a strategic resource in a time of permeable geographic borders and disappearing industry silos. Boards and nominating committees must assess in an ongoing, systematic process the mix of attributes needed around the boardroom table, and the board chair must create a platform of trust, cohesion and common standards. This effort will pay off by allowing the board to be a truly strategic resource for the various stakeholders, the CEO and senior management team during a time of rapid change.

About Russell Reynolds Associates

Leadership. In today's global business environment, success is driven by the talent, vision and leadership capabilities of senior executives.

Russell Reynolds Associates is a leading global executive search and assessment firm with more than 300 consultants based in 39 offices worldwide. Our consultants work closely with public and private organisations to identify, assess and recruit senior executives and board members to drive long-term growth and success. We value teamwork, serving our clients with a collaborative approach that spans our international network of sector and functional experts.

Our in-depth knowledge of major industries and our clients' specific business challenges, combined with our understanding of who and what makes an effective leader ensure that our clients secure the best leadership teams for the ongoing success of their businesses. For more information, please visit us at www.russellreynolds.com.

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