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Thought Leadership contribution: **BOARD COMPOSITION - Old and New Challenges!**

Why another article now about Board Composition?

We are living in challenging times and it is not only the geopolitical situation that has changed dramatically. It is evident that the rate of acceleration of technological developments continues its relentless increase. Business models constantly need to be assessed and, in many cases, re-defined.

The EU's stated aim to become the first CO-neutral area is setting new standards and with ESG having become a game changer the Financial Sector is clearly targeted as a key sector in achieving the EU's aim. Within these circumstances we see that Boards are more than ever held accountable, be it by stakeholders, activists or regulators.

To these already multiple challenges for Boards, we experience increasing regulatory stipulations and cost pressure, but the fundamental principle remains that "Boards should ensure the application of high standards of corporate governance at all times" (ref. 1).

With all this in mind, the question is:

How can Boards ensure that they are, or remain in, a position to face all these challenges and achieve their multiple responsibilities to the various stakeholders of their respective company?

1. Self-Assessment

Firstly, the Board must consist of members that have the required knowledge, experience and skills to fulfil their responsibilities, and the starting point for understanding this is an honest assessment of the Board composition and its members' abilities through Board self-assessments conducted on a regular basis.

In addition to a regular assessment certain trigger points occur which should naturally lead to a Board considering its current and future composition. These may include when a Board member steps down, perhaps through the regular practice of rotation, or retirement, or when a new or substantially modified business strategy is decided. Such an assessment can also help the Board with the strategic aspect of succession planning and identifying where the Board dynamics may profit from the introduction of 'new blood'.

This exercise of a self-assessment should include a skills matrix showing all the Board Directors' fields of expertise. By performing this exercise, the potential gaps coming out of the analysis should make clear what kind of attributes a new member of the Board should bring in, or indeed, what training existing members may require to fulfil their responsibilities. **However, in Luxembourg, 46% of the Boards participating in that study do not perform a self-assessment** - see ref. (2), **there is obviously room for improvement**. The analysis of the respective Board members' tenures and reflections about if and how this may affect the directors' independence (of mind and economically), objectivity and performance will also be on the table. But today we will not touch upon the question of the value add of Independent Directors as this has already been the topic of a recent Thought Leadership paper of EGP (www.eg-partners.eu).

2. Skills Matrix

What should be the relevant criteria contained in a skills matrix?

The Board being collectively responsible for the company should have sufficient expertise in the vast majority of the value chain elements of the sector in which the company operates as well as the supporting areas (e.g., Finance, HR, Compliance, Risk Management etc.). This does not mean that every director needs to be an expert in all the areas, but the **diversity in respective backgrounds and professional experiences** of each of the Board members should be such that the Board has the collective expertise to take appropriate decisions and to perform the required oversight duties. Executive Management and the Executive Directors of the company should be able to view the Board as a constructive source of challenge when it comes to discussing strategy and other matters that require the agreement of the Board.

This opinion is fully backed by the results of a recently published survey (see ref 3): "very interestingly, industry expertise and leadership experience are now back at the top of the list of attributes Boards are now seeking in their next director appointment—after having given priority to background, racial and gender diversity last year as the top three criteria they were seeking. Anecdotally, directors say they have the diversity they need at this time and are therefore focusing on onboarding certain missing skillsets".

In the Financial Sector, we have seen this in recent years, when Management Companies expanded their offerings by for example, adding "alternative funds". Boards were complemented with personalities knowledgeable in Real Estate, Infrastructure, Private Equity etc. We will come back to further aspects of diversity later.

The skills of the Board should also be continually enhanced by Board members investing sufficient time in continuous professional training and education.

3. **Commitment**

The next obvious required attribute for a good Board Member is her/his **commitment**. Each Board member must act with due care and diligence, they should act fairly and independently (again see ref. 1), commit enough time to properly discharge their duties and prepare well-informed discussions and decisions. This is especially important in times of crisis where the number of hours to be dedicated to a mandate can quickly multiply.

The Board, as well as any candidate invited for a vacant position, should be sensitive to potential conflicts of interest. Most companies will certainly have and will maintain respective policies and registers detailing how they go about identifying and managing these. While not completely excluded by regulation it should go without saying that an independent director must consider very carefully whether it is appropriate to take a mandate at the ManCo level and at a SICAV managed by the ManCo at the same time.

4. **Diversity**

An article about Board Composition nowadays is certainly not possible without touching upon the aspect of **diversity**, this term being interpreted as broadly as possible, e.g., gender, age, ethnic, cultural, international, education, professional background etc. As a confirmation, the study already mentioned (see ref. 3) states that “the pressure has increased for companies to engage with broader groups of stakeholders, demonstrate their commitment to the communities they serve, and for boards and their leadership teams to diversify their ranks to be more representative of the company’s constituents”.

In the past years, a lot of emphasis has been put on *gender diversity*, and it is probably fair to state that on one hand progress has been made and that on the other hand there is still quite some work to be done. But can and should diversity stop here? In our opinion the answer is a clear “NO”.

In a more and more digitalized global world, digital and cyber expertise have become far more relevant, and these knowledge areas will typically be found with younger persons. Is it time for a few heads with less grey hair in the Boardrooms?

The same might be applicable for other fields. In view of recent EU stipulations, supply chain and environmental/climate expertise have gained enormous importance. So why not invite an engineer or scientist to a Board of a company active in the Financial Sector managing ESG funds instead of “only” lawyers and economists? Also, a company active in very different geographical areas from Europe could gain benefit from intercultural knowledge of a person from that respective region, to advise on cultural sensibilities and to assist with access to a new regional network.

The Board should ask itself if the Board, and/or Senior Management, is sufficiently diverse to be aligned with the company’s strategy? If not, or least not yet, should it define the required diversity and set diversity targets, and when should progress against those targets be reviewed?

Should HR have an analysis done about the succession and development plans for the main levels within the company in order to insure diversity, in all its meanings? What kind of information will be disclosed to the stakeholders?

The number of Board members are often limited and it is proven that too many members in a Board are detrimental to decision making. However, a Board of three could probably bring about a significant improvement in diversity by perhaps expanding to five members without the Board becoming too large. For larger Boards, solutions can consist in either appointing advisors to the Board or the founding of a committee consisting of Board members, Executives and specialists for the specific topic.

5. **Culture**

We must mention another very important aspect when dealing with Board composition that of culture, an area that is much focused on by some regulators following the financial crash.

It is widely accepted that “the tone is set at the top” and this means at Board level. This is not only important for Risk Management, Internal Control as well as Compliance matters, including (zero-)tolerance with regard to Money Laundering / Terrorist Financing. Of equal importance are more aspects such as communication, the working atmosphere in the company, mutual respect, non-discrimination, how employees deal with clients and each other. It is not only important THAT the company’s goals set are achieved, be it financial, operational etc. but also HOW these outcomes are achieved. So before inviting candidates for a vacant position, the Board should clearly reach a common understanding in this field.

6. Values

Maybe one last aspect of the composition of Boards to mention came out as a learning during the Corona crisis. A candidate for a newly created Board position was invited as a guest to a working session to get to know and talk to the entire Board. The candidate was very well qualified and the number one on the short-list of potential candidates, however not only did he proceed to categorically reject to respect both the official and company-specific COVID protection provisions that were in force, but shared his support for various conspiracy theories. So perhaps one of the most important lessons is that there must be a sharing of **fundamental values** with your colleagues if a Board is to work together successfully.

Conclusion

So, our question at the beginning was: Why another article about Board Composition?
Because it is most relevant. Relevant for YOUR Board and YOUR Company!

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- 1) ALFI Code of Conduct
 - 2) The State of the Luxembourg Board Room, ILA/Diligent (published in 02/2022)
 - 3) Corporate Board Member / Diligent Institute Research Report: What Directors think (12/2021)