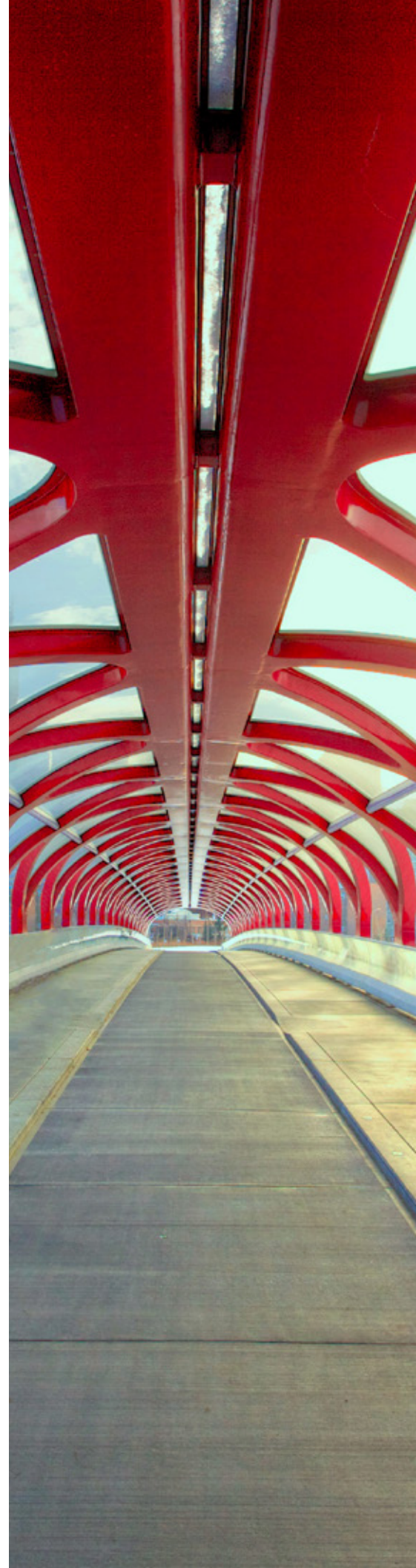


The Evolution of Canadian Boards

Assembling the best team for a changing game

To gain firsthand insight into how today's directors are feeling about the current state of governance and what lies ahead, we interviewed a group of experienced directors and board chairs of leading organizations across Canada, a number of whom have served on U.S. and international boards. As such, they bring a wide perspective from different markets and varied experiences, leading the charge toward a greater focus on performance and artful board composition. They are engaged. And none of them sees the world of governance standing still. Here, we share the dominant themes from our discussions, and offer some perspectives on what can be done to accelerate change, improve board dynamics, recruit the best directors with the right fit, strengthen and align board culture, and raise overall board effectiveness to meet the performance requirements of the future.



A NEW PLAYBOOK FOR BOARDS

New trends in board governance and a rapidly evolving business landscape require many companies to rethink how they can derive the most benefit from their boards. Here are some key issues to consider and how Spencer Stuart can help.

Board composition, size and diversity impact performance. Detailed skills matrices and third parties can support recruitment and search efforts for top candidates who bring diverse backgrounds and perspectives. Spencer Stuart's Board Intrinsic[®] tool can help move beyond a traditional view of skills and experiences to delve into Executive Intelligence, decision-making and interpersonal skills. Board effectiveness studies and thorough board evaluations can also help boards better assess individual director performance.

Board performance and culture are undeniably connected. Most directors say they rarely talk about culture unless they are recruiting new directors. More board members see focusing on board culture as the route to better board performance. Spencer Stuart's leading-edge Culture Alignment Framework tool helps diagnose the current culture of the board and enables boards to shift toward a more aligned culture. With a more precise understanding of the board's current and desired culture, the "fit" of prospective directors can be assessed more accurately.

Boards must balance engagement, workload and compensation. As directors often point out, the size of the company does not always correlate to the amount of board work required. And there should be some flexibility in the design of compensation for directors of emerging and smaller companies. Reviewing the board composition, share ownership, compensation practices and governance structure of peer companies can aid in benchmarking where your board should stand on these issues.

What is the role of the board in combating short-termism and other capitalization trends? Across the country, boards are tackling the gap between the long-term value creation mandate of boards and the short-term approach of some investors. Governments are testing the market and their appetite for privatization of public sector organizations. Public companies are contemplating going private. These forces and shifts can create the need for new skills in the boardroom and dedicated discussion about board succession. Spencer Stuart can bring market insights, expertise and process to these discussions, leveraging our board advisory expertise and market-leading practices serving boards and a range of industries and functions.

The selection process does not always reflect the integral role of the board chair. When discussing culture, board performance, succession planning and board dynamics, all roads point back toward the quality of the board chair as a determining factor for success. Is the board chair selected through a rigorous process? The models used in broader succession planning and in selecting new directors can be deployed to ensure the chair's selection is made effectively.

BOARD BASICS ARE ANYTHING BUT



Recent catastrophic threats to firm survival caused by IT security breaches, as well as reputational risk and business slow-downs caused by neglecting key stakeholder issues, have prompted boards — and sometimes shareholders — to question with greater urgency what skills and expertise are needed in the boardroom. Time and again in our conversations, the skills matrix was heralded as the key to successful renewal and thoughtful board composition, beginning with a thorough discussion of the strategic direction of the organization, its risks and future opportunities. There was a clear recognition that relevant industry experience is critical, as is knowledge of a firm's current geographic markets. A focus on global and emerging markets is rising in importance, even for organizations that are currently solely domestic.

But some challenges facing boards are just too specialized and fast-moving to expect a director to close the board's knowledge gap. "It's what you don't know that's going to get you," said one director. There is also a stale-dating of industry experience at the board level that must be addressed, particularly in faster-cycle industries (e.g., communications, financial services, technology), and with emerging challenges like cyber risk or social media. However, many cautioned against adding directors with highly specialized skills; instead, expert advisers can be brought in to educate the board.

The future board skills matrix will by no means be one-size-fits-all. "We should have a behavioral skills matrix as well as a conventional skills matrix," said one director and former CEO, who noted the importance of individual director performance. "That way we'll know if we're bringing the right person on board, and we'll have another way to evaluate how the board is doing overall."

The bar is being raised as the role of director becomes more professionalized, making ongoing education all the more vital to remaining current. While no directors cited a governance designation as a prerequisite, many applauded such professional training for helping to shine a light on the importance of education, raising the standards and expectations for performance.

The 'just right' size

Board size is also on the minds of many. Like the story of Goldilocks, there is a "too big" and a "too small," though 10 to 12 directors seems to be a size at which most boards believe they "can assemble the appropriate set of skills, get increasingly complex and demanding committee work done, yet not lose accountability around the table," as one director put it. Board size was particularly relevant when evaluating the skills needed to navigate emerging challenges and opportunities. Many noted, for example, that it was important not to increase the size of the board just to meet these needs, recognizing a board can lose its effectiveness if it gets too big. One director observed: "We continue

to do more, meeting more frequently than ever before. A board seat is an expensive and important piece of real estate, so we need to try to get the best people in those positions.”

Improving diversity

Better board performance is the best reason to focus on diversity and renewal, said several directors when asked about the growing focus on these issues. Proactive board renewal is a much-lauded mechanism to achieve the right board composition, whether it be to manage the average tenure of the board, address independence issues, enable greater diversity in terms of age, experience, gender and behavioral styles, or to deal with the growing demand for industry-specific experience. While term and age limits were raised as mechanisms to accelerate renewal, many pointed to individual board member performance as the most powerful means by which the board of the future should manage its renewal. Board effectiveness reviews, undertaken by the boards themselves or facilitated by a third party, can provide critical insights into the individual performance of directors, shed light on how and why boards perform well — or don't — and prompt board renewal discussions that may otherwise not occur.

Interestingly, despite all of the attention around gender diversity, including new “comply or explain” regulations requiring disclosure of policies and targets for the number of women directors, both the male and female directors we interviewed said that an increased focus on board renewal, with a clear emphasis on composition and commitment to finding the best candidates would naturally lead to more diverse boards. Many said that, everything being equal, boards choosing between equally qualified male and female candidates should select the female candidate; few of the directors we interviewed advocated quotas or forced actions to put women on boards.

Applying a broad-based approach to searching for new directors in diverse and perhaps unconventional talent pools can open the door to fresh prospects. In-depth skills and assessment tools, such as Spencer Stuart's Board Intrinsic[®], help to evaluate Executive Intelligence, decision-making skills and interpersonal fit, and ensure that potential directors (including untested talent) will be able to not only add value to the board, but also be able to work effectively with the other board members. The best-performing teams are often not made up of the best individual athletes, but rather a group of high performers who fit well together and complement one another's skills and personalities.

BOARD PERFORMANCE AND CULTURE: INEXTRICABLY LINKED

Board performance is under scrutiny from many vantage points. Beyond the need for strong individual director performance and cohesion among all board members, a board's culture enables the kinds of open conversations that get to the heart of the matter. The board chair plays a key role in ensuring that constructive and positive feedback is provided to board members. While that sentiment was echoed in our interviews, several directors pointed to externally led processes as the key to providing the necessary structure and objectivity, as well as the facilitation often needed to make 360-degree review processes a positive and productive experience for all.

The board's culture was viewed as the single most important enabler of a better-performing board and, therefore, better stewardship of the company. While culture — the set of norms and behaviors, values and principles exhibited by the board — was deemed to exist from the very beginning of any board, it was also seen to be within the purview of the board chair to maintain, change or reset, if necessary. One experienced director and former C-level executive likened culture to the “Queen Mary,” “slow and difficult to turn,” and noted that culture is seen as the reason boards and organizations succeed or fail.

A healthy board culture allows difficult discussion to arise, ensures that individuals are held accountable for their performance, and that the collective wisdom and experience of the board is brought to bear on the challenges of the day. In fact, many said cultural fit is a key screening criterion for prospective board members and an important measure for existing board members. However, choosing someone who fits the board's culture doesn't mean choosing like for like, nor does choosing a director for cultural fit mean the integration will always go smoothly. Often, those with a different approach or personality can help a board's culture evolve.

Complicating matters is the inherently nebulous nature of culture — it can be hard to describe and, as a result, it is rarely discussed. The unspoken rules of engagement in a boardroom can either thwart or optimize the performance of a collective of brilliant minds and experienced executives. Culture needs to be front and center for boards in the future. By utilizing a rigorous approach for diagnosing the unique cultural dynamics of board and individual director styles, such as Spencer Stuart's leading-edge Culture Alignment Framework tool, boards can assess the potential fit and impact of new directors, as well as how the current board functions as a team.

ENGAGEMENT, WORKLOAD AND COMPENSATION: WHAT IS THE BEST GAME PLAN?

New regulations and external pressure for greater disclosure and transparency around decision-making have led to a substantial increase in the amount of work for the audit, governance, and human resources and compensation committees. Additionally, global economic uncertainty along with faster-cycle industry changes have led to the need for more special committees as boards contemplate strategic options. The workload for directors has increased, and the scrutiny around board member performance, accountability and reputational risk are not for the faint of heart. One director pointed out that while director pay is correlated to company size, there is no direct correlation between company size and the amount of work required to support the organization. The emerging trend toward flat annual fees, rather than per-meeting fees, is a slightly worrisome trend for directors of smaller boards, where workload is similarly high with a preponderance of corporate transactions and off-cycle board meetings.

Directors see the trend of increased workload persisting, but director compensation has not risen commensurately in all sectors. Larger workloads will result in less capacity for conscientious directors to take on additional boards. Over time, even more capable and qualified directors will likely be needed. Many board members expressed a desire to keep improving board performance (and their value to the organization) through their own

experiences as executives, but also through ongoing board member development. While most would not turn down additional compensation, they acknowledge money is not the prime motivator — doing a better job as a team for the companies they serve, is.

THE ROLE OF THE BOARD IN COMBATING SHORT-TERMISM: TO PRIVATIZE OR NOT TO PRIVATIZE?

The concept of short-termism and the challenge of multiple stakeholders were popular topics of conversation. These are issues that do not lend themselves to black-and-white answers. “We can’t be all things to all people,” said one director, “and the board needs to be aligned around its value proposition.” Others mentioned the perverse outcomes that tight linkages between share price, executive compensation and short-term performance goals can create, all of which are exacerbated in a down market.

There was some debate during our interviews as to whether or not a public company structure results in greater long-term value creation. In addition to reducing the need for very transparent, potentially anti-competitive disclosure, the higher costs of running a public company are avoided when organizations opt to stay private. However, some of the directors we interviewed argued that activist investors, or those with shorter time horizons, can, in fact, be beneficial in incenting boards to focus more on performance outcomes and making difficult strategic decisions. A determined, clearheaded and aligned team of executives, directors and board chair, is required to maneuver through the ongoing mismatch between long-cycle industries and short-cycle owners.

BOARD CHAIR: A ROLE UNRIVALED IN COMPLEXITY AND DIVERSITY OF SKILLS

The importance of the quality of the board chair topped directors’ list of concerns. “The selection of the board chair has not attained the status it should among critical board decisions,” one director said. “It can be the single most important factor in predicting the performance outcome of a board.” The board chair must not only know the business and the industry, but also be able to effectively lead a high-powered group of individuals, build an effective relationship with the CEO, manage a strategic board agenda, and keep a group focused on substantive matters, while also allowing for sufficient blue-sky discussions and thoughtful in-camera sessions. In addition, the board chair must skillfully read the dynamics of a room, drawing out the more introverted directors and managing the more extroverted ones, while metering his/her own views alike. “The board chair mandate has to be elastic, particularly as companies go through major transitions and strategic junctures,” said one board chair. “The chair needs to play a much more visible and active role at such times.”

The board chair should embody a rare collection of skills and experiences, one that requires a careful selection process even more robust than the recruitment of a new director. With regard to moving toward a U.K. model, where board chairs are often chosen through an externally run process, most prescribed increased focus on board succession and a carefully run internal selection process as a more palatable and practical approach. One director noted a need for much more transparency around

board chair succession, akin to what should be the case for overall succession planning in an organization.

In the evolving world of governance, many see the board chair's role in proactively managing board renewal as being critical, maintaining an open dialogue and routine discussion around appropriate terms for directors. One director posited that the best directors step down from boards closer to when they have reached their personal peak performance, and well before hitting their "best-by date." One board chair said, "Ongoing renewal should be a common topic of conversation so there are no surprises. Great directors will go earlier, often making room for an even stronger breed of directors to take their places." It is up to board chairs to create the conditions where this kind of renewal can happen for all seats on the board, including their own.

A CHANGING PLAYING FIELD FOR BOARDS

A number of forces are changing the rules of play for boards. There is a renewed focus on individual director performance. Private companies are increasingly focusing on the quality of their governance in light of emerging trends in corporate performance; independence is becoming a more popular topic and new directors will be required to answer the call. Pension funds are also increasingly investing in companies and establishing funds, leading to a need for highly capable directors at even more organizations.

More boards are paying increased attention to specific skill-sets to ensure their composition reflects the needs of today and tomorrow. As the average age of board members continues to rise, some directors we spoke with felt that organizations may need to accelerate discussions around active board succession and more board renewal. Many board members also expressed the need for the role of director to be professionalized through ongoing education and a focus on individual performance.

All of these signs indicate that both existing and aspiring directors should focus on getting ready to compete. Being experienced and available to serve is simply not enough. Engaged, qualified, hard-working, accountable directors with diverse backgrounds, skills and experience will continue to be in high demand. Game on.

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Privately held since 1956, we focus on delivering knowledge, insight and results through the collaborative efforts of a team of experts — now spanning 56 offices, 30 countries and more than 50 practice specialties. Boards and leaders consistently turn to Spencer Stuart to help address their evolving leadership needs in areas such as senior-level executive search, board recruitment, board effectiveness, succession planning, in-depth senior management assessment and many other facets of organizational effectiveness.

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