Board Talent Getting Scarcer

As pressures mount on CEOs they're serving on fewer outside boards, making seasoned directors harder to come by

by Julie Daum

Institutional investors and activists have got their wish for more independent and powerful boards, but not without unintended consequences. In a time when more is demanded of corporate boards, new directors often have less experience than their predecessors had when they joined a board—a potential problem for board effectiveness.

Boards, through the nominating and governance committee, have assumed responsibility for identifying and recruiting new directors. This committee is more strategic now than in the past in identifying criteria for new directors. The committee is casting a wide net to identify and contact the best candidates, going beyond the traditional practice of looking at people they know. However boards are experiencing increasing difficulty in getting candidates to accept director positions. The result is boards with more diverse backgrounds, but with less experience, maturity, and scope than boards of the past.

Finding Alternatives to CEOs

The principal challenge now is that few active chief executive officers, who bring the most experience in running a company, will serve on boards of other corporations. The job of CEO is more demanding, and the job of a director requires more time and preparation than ever before. As a result most CEOs don't have the time to serve on a board. Secondly, the job of a director carries greater risk than in the past of lawsuits and loss of reputation, and there is the threat of heavier pressures from institutional investors and shareholder activists.

Further, more boards are telling their own CEOs to stick to their jobs and not to serve on outside boards, or at least to limit their involvement with other boards. Today the average number of outside boards on which active S&P 500 CEOs sit is less than one, a dramatic decline from 10 years ago, when the figure was two. Among the top 20 CEOs in the S&P 500, only six serve on an outside board. In 2007 active CEOs represented 33% of all new independent directors, down from 41% in 2002 and 53% in 2000.

Activists may smile because this change has disrupted the so-called "old boys" network, but boards now are missing much of the collective wisdom that CEOs bring from facing comparable issues, making decisions under pressure, and responding to multiple constituents. Because they cannot readily attract active CEOs today's boards are turning to other sources for directors, among them divisional executives with strong general management credentials but without enterprise-wide experience, and specialists in disciplines such as finance or information technology.

First-Time Directors

As a result, for each of the last two years, about a third of newly added independent directors are serving for the first time on a public company board. The increasing share of new directors across the entire S&P 500 is consistent with what we are seeing in Spencer Stuart's own placements of directors.

As they appoint more directors who are new to the role, it will take longer for companies to have the most effective boards. To learn the job of a director takes time. Moreover, since many first-time directors are active executives, they are limiting their service to one board rather than several. So it will take longer for first-time directors to gain the experience required to serve effectively than it would if they served on several boards.

All new directors have challenges that limit their value for their first year or two. They must learn about the company, its business, its management team, and the culture of the board. For first-time directors there is even more to learn. They must learn how to translate their narrower experience into guidance of a total company. They need to understand their role of governance vs. management, and they will see issues that normally do not reach a divisional executive. As a result, new directors tend to defer to senior directors with more experience, but this is not optimal. Today's boards are small and require every director to pull his or her weight. A new, first-time director may slow down or weaken effectiveness.

Boards need seasoned executives in the room. This is one reason why more boards are raising the mandatory retirement age for directors—both in recognition that it is getting harder to recruit experienced directors and in hopes of retaining the good ones already in place. Two-thirds of the S&P 500 boards that specify a retirement age now set it at age 72 or older, up from 35% in 2002. And 11% now set their retirement age at 75 or older, up from just 1% five years ago.

How Effective Boards Operate

Boards are like any team. Directors have to find their roles and know how to work with other directors to achieve consensus. A well-functioning, mature board understands its advisory role and does not meddle in management decisions. It has a solid understanding of the company, the culture, the management team, and its dynamics. It fosters trusted relationships among directors that allow free and open discussion and harmonious action. It encourages strong communication among directors, and it has a high degree of self-confidence.

An effective board operates in the best long-term interests of a company, and offers a wealth of experience to the CEO and management team. It knows how to lead and has in place an independent chairman or strong lead director. While some of this can be learned through diligent study and director-education programs, much of it depends on experience gained in the boardroom.

There are some things boards can do to help first-time directors. New directors should receive an in-depth orientation in all aspects of the company upon appointment. Boards should assign new directors to committees where they can gain experience quickly. Some boards are assigning unofficial mentors. Lead directors or chairmen should go out of their way to ask new directors for their insights in relevant areas, to incorporate the newcomers into the team more rapidly. In regular self-evaluations, boards should ask how far along new directors are in the maturation process, how much farther they have to come and, specifically, what the next steps should be.

Boards need to recognize the challenges they face with inexperienced, first-time directors. It is not enough to assume they will catch up. There are too many issues facing boards, and too much pressure to assume that a laissez-faire approach is sufficient.

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