

# “Board Refreshment”, Anyone?



## **Introducing Board 2.0**

A New Tool for Board Succession Planning

Featured in *The Corporate Board* - Jan/Feb, 2021

Board Advisor, LLC – New York

## “Board Refreshment”



...the euphemistic term that conjures up images of someone circling the boardroom with a tray of ginger ale and cookies. It’s back in the spotlight again.

Latest research by PwC found that board succession planning was an area where many boards could improve; 10% of the 700 directors included in the study said their board had no succession plan, 33% said it was “ad hoc” and 49% of those who had a succession plan indicated that the plan wasn’t shared with the full board.

Board composition is probably the single most fundamental component of board effectiveness- and a deeply personal issue for most board members. It’s important for every director to weigh in on this critical question, reach alignment around it and then move forward. A “black box” approach to board succession is a prescription for director disharmony.

That’s where Board 2.0 comes into play. It’s a new board succession planning tool that engages every member of the board – and, typically, top executives as well – in designing the board’s optimal future composition, taking into account the company’s business model, long-term strategy, ownership structure and other critical factors. Rather than simply “filling in” board vacancies occasioned by director retirement, Board 2.0 is an opportunity for the entire board to stand back and look at board composition holistically and strategically – then plan for the future.

Board 2.0 was featured in the attached article from the January/February 2021 issue of The Corporate Board, which describes how the process works and what distinguishes it from the Board Skills Matrix and other board succession planning vehicles. Board Advisor also offers individual sessions for Board Chairs, Nominating/Governance Chairs and/or the full Nominating/Governance Committee on Board 2.0 and related issues in board composition design and director orientation. For more information or even to set up an informal call to discuss what’s involved, just email us at [Beverly.behan@boardadvisor.net](mailto:Beverly.behan@boardadvisor.net).

# Board Evaluation: Building Board 2.0

by Beverly A. Behan

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**So much of the board evaluation done today is backward looking. What are our current skills and experiences, and how do we add replacement directors to fill these roles? Beverly Behan, in an excerpt from her new book, suggests a “Board 2.0” approach that turns this old model upside down—what talents will our board need in the future?**

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“Board refreshment”—the euphemistic term that conjures up images of someone circling the boardroom with a tray of ginger ale and cookies—is back in the spotlight again. Latest research by PwC found board succession planning as an area where many boards could improve: 10 percent of the 700 directors included in the PwC study said their board had no succession plan, 33 percent said it was ‘ad hoc’ and 49 percent of those who had a plan indicated that it was not shared with the full board. Board composition is probably the single most important factor in board effectiveness—and a deeply personal issue for most directors. It is important for every board member to weigh in on this critical question and create a plan that the board can reach consensus on. A “black box” approach to board succession is a prescription for director disharmony.

Roughly 75 percent of the board evaluations I’ve been involved in over the past 25 years resulted in changes to board composition. It was easy to get traction around this issue once you stopped having directors circle one to five in response to closed-ended questions like “Our board composition is appropriate” on a form—and instead asked: “If the board were going to add one new director right now, what skills, expertise or background would you prioritize in a new board colleague?”

Three times out of four, there was clear consensus that a particular background was missing—and good reasons to prioritize it. This, of course, begged the

question: “Should we wait until one of the board members hits the retirement age before we fill that gap? Or, should we find a new director right away with the expertise we need—even if the board expands temporarily? Not all boards chose to address a composition “gap” immediately, but the vast majority did, particularly when there was consensus on what was missing and why it was important.

The “Board 2.0” concept originated during a client project where three boards were being merged into one. Politics was running rampant around the thorny issue of who would stay and who would go in the creation of the new board to oversee the merged entity. We wanted to cut through the politics by having some objective and practical criteria for director selection. We wanted to create a truly outstanding board, with the right mix of skills and expertise to make a big difference and add real value in overseeing this merged company.

**Focus on the best possible board composition in terms of skills/expertise, given the company’s business model and strategic direction.**

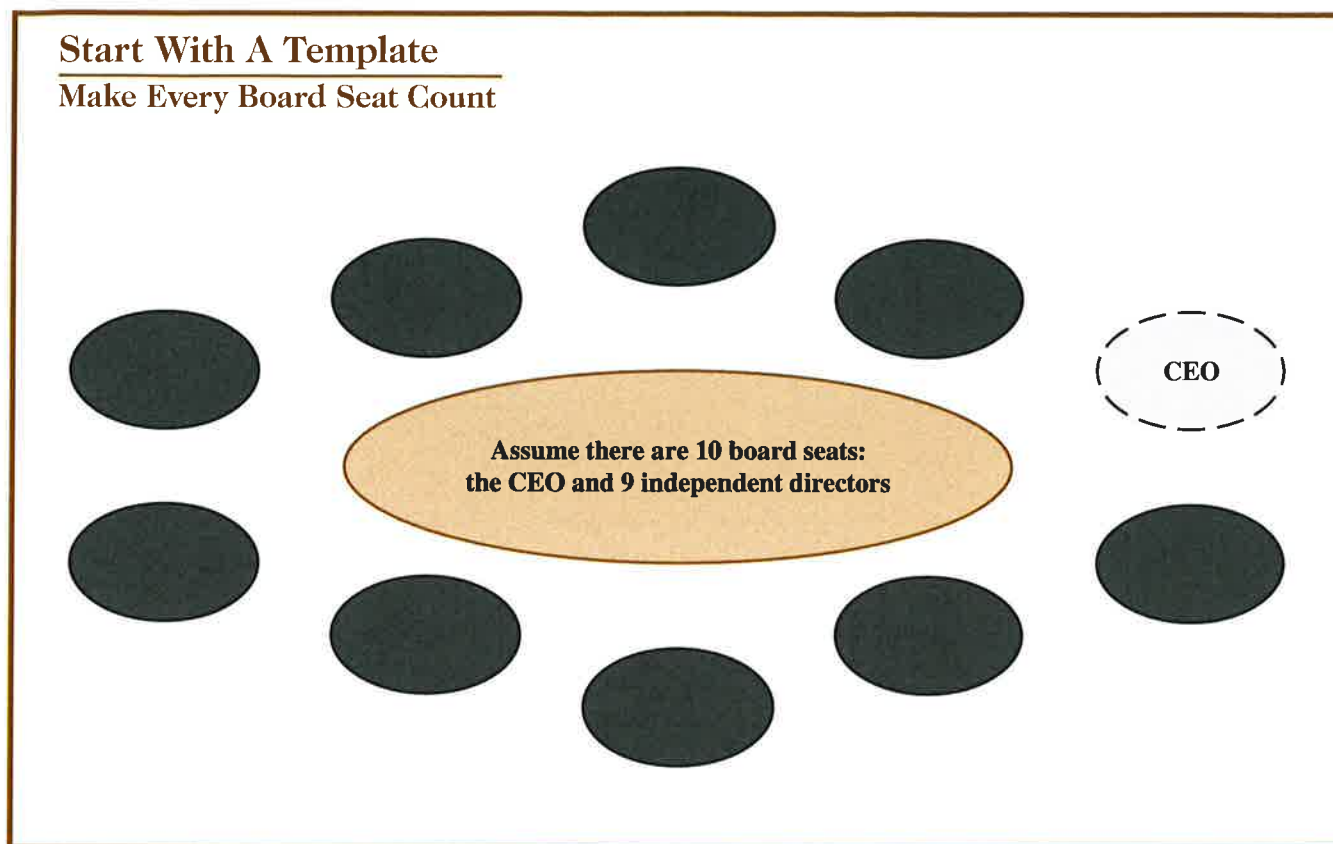
Many boards at that time were using a Board Skills Matrix but, for various reasons, I did not think this approach would achieve our aims. So, I decided to take a different tact, one that engaged all board members and executives personally, forced prioritization and focused on optimizing the mix of expertise on the new board. I sat down individually with every director serving on each of the three boards, the CEO who would lead the merged company and several members of his executive team. I told each interviewee to assume:

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## Start With A Template

### Make Every Board Seat Count



□ That the new board (Board 2.0) would consist of a total of 10 directors.

□ That one of the board seats would be allocated to the CEO, leaving nine for independent directors, one of whom would serve as board chair, consistent with their current practice.

Then, I asked each respondent what skills, experience and/or background they sought in each of these nine board seats to create the best possible board. This was not a vote on who should remain at the board table and who should leave. It was an effort to define the optimal skills and experience to effectively govern the new company.

In working through the Board 2.0 exercise with each interviewee, I found that I needed to do two things. First, keep the respondent from giving too much consideration to the people already sitting on the three predecessor boards. I wanted them focused only on the best possible board composition design in terms of skills/expertise, given the company's business model and strategic direction. Sometimes, this resulted in recommendations of backgrounds

not found among any of the directors serving on the three predecessor boards.

Second, avoid generalities. I wanted to understand the reasoning behind the background each interviewee was recommending: How did it relate to issues that Board 2.0 would be grappling with?

For example, if the respondent said "I'd certainly want two or three people with experience in our industry," I would ask how he/she was defining the "industry." Some respondents had a narrow definition (medical insurance); others saw this question more broadly ("anything in healthcare"). I would ask what sort of job within the industry the individual should have held: Should they have been a CEO or COO? Or in the role of chief medical officer? What were the reasons for their recommendations?

It was also important to use a finite number of board seats. This forced interviewees to prioritize how best to "spend" each of the nine available seats. Occasionally, I'd allow them to expand the board size by one or two, if they were bubbling up some really good ideas. Still, I was always firm about specificity.

Out of more than 35 interviews, no two were the same. However, an optimal board makeup began to emerge. Of the nine independent director seats, there was strong alignment with respect to the background/expertise that should be in six of them. As for the others, there were several pockets of agreement. In the end, it was not difficult for all three boards to reach consensus on the final design for Board 2.0.

The Board 2.0 exercise worked so well that I began adapting it to other client scenarios where boards were undergoing major transitions:

□ **Significant change in business/strategy.** The company had sold its largest division and used the proceeds to make an acquisition in a new line of business, somewhat adjacent to but dramatically different from its core business for 20+ years. The acquisition was already generating nearly half the company's revenues and expected to grow significantly over the next five years. This company was dramatically transitioning its business, but had yet to transition its board to reflect these changes.

□ **High level of board turnover.** Four directors (one-third of the board) would all reach the board's mandatory retirement age within two years' time. The company also had a new CEO who wanted to derive more value from the board. He was concerned that the governance committee seemed overly focused on replacing the skills that would be lost through the upcoming retirements. Before any recruitment began, he wanted to reconsider the board's entire composition.

□ **Initial public offerings.** One IPO involved the spin-off of a major division of a Fortune 500 company. Another was a company that had their IPO 18 months earlier; the private equity investors were now selling down their positions and time had come to replace their seats at the board table with other directors. Both involved wholesale board composition design.

Is there an optimal board composition? No, there is not, just like there is no "perfect board size." I have seen boards of seven directors operate extremely effectively, and I have seen a board of 13 (which most would describe as "far too big") hit it out of the park. The latter had an outstanding chair who facilitated great meetings, and a mix of skills and expertise that

brought insightful and varied perspectives into the board discussions. Frankly, any board size within that range can probably work. Far too often, the mantra of maintaining the current board size is used as an excuse to defer adding much-needed expertise.

Optimal board composition is different for every board and always a work in progress. What distinguishes a well-comprised board is the nexus between the backgrounds of board members and the company's business and strategic direction. Directors need to have the kind of experience which allows them to credibly "throw down the gauntlet" to management if something proposed seems ill-considered, and call the question on corporate performance issues. At the same time, directors' backgrounds should enable them to inject perspectives that expand management's thinking and raise "red flags" that may be a risk to the company, its shareholders and/or other stakeholders.

When you look at directors' backgrounds on a company's website or proxy circular, you should be nodding your head as you read those bios thinking "Yes, it makes a lot of sense to have someone with that background on this board." You should not be scratching your head, puzzled as to how this person's experience seems relevant and wondering how he/she could possibly make worthwhile contributions.

The real job of a nominating committee is not simply to recruit, nominate and re-nominate directors, the wording of most committee charters. Rather, it is to put the best possible team of directors on the field to govern this company effectively. It is readily apparent from looking at a board's composition whether the committee has been largely fulfilling that duty—or falling woefully short.

**Begin your Board 2.0 exercise with two assumptions. The board is not to be a "shadow management" team, nor is it a focus group.**

In working through a Board 2.0 exercise, two assumptions about board composition design sometimes arise, which need to be debunked.

First, a board is not a "shadow management" team. Some respondents want every board seat to match

## Board 2.0 And Diversity

### First, Define Your Needs

A NYSE-listed financial services company had recruited an African American director in the late 1990s when he retired from a Wall Street firm. Eventually, he hit the board's mandatory retirement age. The nominating committee sought to replace him, but the ex-Wall Streeter that rose to the top of the candidate list this round was a white woman.

Having another female director was considered an asset, but the board now lacked a director of color. They asked their search firm for a list of African American board candidates, with little else to go on in terms of background or expertise. The headhunter dutifully produced a lengthy list of highly accomplished black lawyers, ex-politicians, academics and CEOs. Interviews commenced, but none of these candidates seemed to get any traction.

Around this time, the board undertook a board evaluation incorporating a Board 2.0 exercise. This enabled the board to reach consensus on skills and expertise they really needed—a SOX financial expert who could back up and eventually replace the audit committee chair when he retired, preferably a chief financial officer with a banking background.

They returned to the search firm and asked for a list of candidates who met these criteria, specifying that they wanted to see several candidates of color included. When the new candidate list was compiled, the chairman circulated it to all board members and corporate executives,

asking if they knew anyone on the list.

One of the corporate senior vice presidents immediately called the chairman. He was excited by one of the names, a female African American chief financial officer with a banking background who he had worked with in the past. He offered a ringing endorsement: “Donna is one of the most intelligent, insightful, and genuinely nice people I’ve ever had the pleasuring of working with. She’s very well-respected in the financial community. If we could bring her onto our board, she’d be outstanding!”

This endorsement caused the chairman to put Donna at the top of the interview list. After they met her, directors quickly reached consensus: “She was night and day compared to the lawyers and professors we’d been talking to before. Donna really knows our business. You could tell right away that she would be a terrific director who’d add a lot of value to our board.”

“Our problem,” the chair reflected, “Was that we initially went about our recruitment process the wrong way: We knew we wanted a person of color so we asked for diverse board candidates. But we never specified what we were after in terms of background or expertise. Consequently, our headhunter gave us a range of accomplished people—but none of them seemed like a good fit. Once we defined the type of experience we were really looking for, and then asked for diversity candidates who met these criteria, we found a great candidate very quickly.”

up with one of the CEO’s direct reports in terms of expertise—a finance person, a lawyer, a marketing expert, a human resources specialist, etc. This reflects a misunderstanding of the board’s oversight role. The board is required to oversee the company, not each senior executive individually. That is the CEO’s job. Moreover, there may be expertise appropriate at the board table that would not typically reside on an executive team (an economist, a strategy consultant, etc.).

Also, a board is not a focus group. Some people populate their Board 2.0 template based on consumer segments. This is a focus group, not a board of directors. It is a great idea for a children’s apparel company to have some parents on the board, but those parents need to be able to challenge the integration

plans of an M&A transaction, identify risks in a capital financing proposal and determine the key performance metrics that should be included in the CEO’s compensation plan.

Diversity is an extremely important consideration in board composition. Some boards may therefore be inclined to allocate a “diversity seat” in comprising Board 2.0. A far better approach is to agree on the backgrounds and expertise needed to govern the board most effectively and *then* seek out diversity candidates who fit these needs. Creating a “diversity seat” implies that not a single seat in the optimally designed Board 2.0 could be filled by a diversity candidate. Not only is this largely untrue in the 21<sup>st</sup> century, it is an approach that smacks of tokenism.

In fairness, there will not be a rich pool of diversity

candidates to meet the requirements of *every* board seat defined through a Board 2.0 exercise. Talent pools are deeper for diverse candidates in some areas of expertise than others. For example, a director search focused on finance or technology backgrounds will typically yield any number of well-qualified candidates encompassing gender, racial and/or age diversity. For any board consisting of at least seven directors, it is tough to imagine a scenario where diversity candidates could not be found for at least three of the board seats developed through a Board 2.0 exercise—if not more.

**Personal qualities/characteristics are omitted from a Board 2.0 exercise. These are qualities that *all* board members should have.**

Just because a director has a great background and highly desirable expertise does not mean that he/she will actually be effective as a board member. No matter how stellar his/her experience, any director who routinely shows up unprepared, constantly delves into minutiae and adopts an antagonistic tone is not the kind of person any company wants or needs at the board table.

Notwithstanding their importance, personal qualities/characteristics are omitted from a Board 2.0 exercise. This is because these are qualities that *all* board members should have. No one would allocate one board seat for a director with “sound judgment” and another for a director who is a “good team player.” These traits should be expected of each and every member of the board.

While personal qualities/characteristics are important considerations in director selection, ongoing director performance management is every bit as important. This is something most boards do poorly, if they attempt to do it at all.

The PwC board survey, referenced earlier, found 49 percent of over 700 directors surveyed believe at least one of their fellow directors needs to be replaced (and 21 percent think that two or more need to go). The PwC results suggest that half of all U.S. boards are currently wrestling with a director problem that

entails either an expertise issue, a performance issue, or both.

What happens if an incumbent director’s expertise is excluded from Board 2.0? This outcome is almost inevitable, because Board 2.0 is focused on the future. Of course there will be some different skills in Board 2.0 than may be resident at the board today. Companies grow and morph over time. What may have been the perfect board background seven or eight years ago is now overshadowed by other business priorities.

Some momentary drama can emerge when one or more of the current directors’ backgrounds are excluded from Board 2.0. There are two things to bear in mind when this occurs. First, Board 2.0 is the optimal board designed to govern the company in three years’ time—not next week. Second, any director who is not a “match” for Board 2.0 is essentially put “on notice.” This does not mean he/she has to pack up and leave the boardroom tomorrow; but it implies that director might not be staying to the mandatory board retirement age. The nominating committee can either accelerate or defer board turnover, as they deem appropriate, with Board 2.0 creating a useful lever that the committee can use in this process.

How quickly a director who does not fit Board 2.0 departs from the board can depend on a number of factors, because this decision is largely at the nominating committee’s discretion. In practical terms, it is nearly always his/her performance and contributions as a board member that determines the timing.

A director who is not carrying his/her weight, whose contributions are fairly marginal, and whose skills are nowhere to be seen in Board 2.0 will generally be leaving sooner rather than later. Most nominating committees begin working toward Board 2.0 with some director recruitment efforts. No one is asked to leave immediately, the board size temporarily expands. However, the expansion *is* temporary, a first step in the ultimate transition. In these circumstances, about a year down the road, the underperforming director who is not a fit for Board 2.0 frequently offers to resign. If that does not happen, Board 2.0 sets up a relatively straightforward re-nomination conversation

for the committee, if they choose to have it.

On the other hand, a high-performing director who makes extremely valuable board contributions will likely continue to be re-nominated for some time to come, regardless of the fact that this director's expertise is not included in Board 2.0's design. Does anyone care if the board size expands by one seat during the Board 2.0 transition so as to ensure that one of the board's most outstanding directors at still the table?

To prevent a peremptory resignation in these circumstances, make it clear that in the board's view, this director adds tremendous value. Even though he/she may not fit Board 2.0, there is no desire for this person to leave.

### What is the difference between a skills matrix and Board 2.0?

As many directors are familiar with the use of a "Board Skills Matrix," I am often asked about the differences between a skills matrix and Board 2.0.

□ **Board 2.0 is forward looking.** The board skills matrix, by contrast, focuses on current board composition. Many companies include their skills matrix in their proxy circular or corporate website and list their current directors' names beside it. They tick off each category in the matrix for which the director's background is a "fit."

Board 2.0, on the other hand, focuses on the optimal board to govern the company in three to five years' time. These are two entirely different questions, and consequently, they produce different results. This is the reason why some boards actually use both.

□ **Board 2.0 is specific.** A board skills matrix typically uses general categories (such as finance or technology). Personal characteristics are also sometimes included, along with other general capabilities most boards would expect nearly all of their directors to have, such as "leadership" and "strategy." Board 2.0, on the other hand, involves some drilling down for greater specificity, and to understand why a particular background is essential.

□ **Board 2.0 forces prioritization.** There are a finite number of seats around the board table of Board 2.0, which forces decisions about what is really important: How is each board seat most wisely filled? A skills matrix, on the other hand, is typically comprised of a long list of categories with no evident limit.

Because a Board 2.0 exercise is inclusive, engaging, focused and specific, it is generally fairly easy to achieve board alignment on its final design. Moreover, the board clearly understands the director recruitment and other transitions that will be required to achieve Board 2.0. However, the pace of the transition, itself, remains entirely at the nominating committee's discretion. ■