Recruiting for the Board of Directors

In today's challenging business environment companies must exploit every competitive advantage. One of the most important is having a skilled and engaged board of directors.

Yet by their own admission, most boards aren't living up to their potential. As Beverly Behan points out in her book *Great Companies Deserve Great Boards*, only a small percentage of respondents to surveys by the National Association of Corporate Directors rate their own boards as "highly effective." Clearly, boards can improve.

What constitutes a great board? The best boards go beyond the narrow functions that are dictated by their charters, and add tremendous value through proactive support of management's efforts to advance the business. An outstanding board gives advice on areas in which members are expert, provides new and valuable perspectives on business challenges, leverages its contacts for the benefit of the business, and in general supports management and helps it achieve outcomes that are far better than it could have achieved alone.

Take Apple's board as an example. When Steve Jobs came back to Apple in 1997 he remade the board, and over time he populated it with heavyweights with a wide range of experience. Among others, the board included Larry Ellison of Oracle, Arthur Levinson of Genentech, Ed Woolard of DuPont, Andrea Jung of Avon, Bill Campbell of Intuit, Jerry York of Chrysler, and Marty Drexler of the Gap.

This powerful brain trust, according to Walter Isaacson's biography of Steve Jobs, made important contributions to the company's strategy. Jobs led them in "freewheeling discussions" about critical strategic issues like the switch to Intel processors and the launch of Apple retail stores. Jobs also called on board members when he needed their unique expertise–for example, retail expert Marty Drexler played a pivotal role in helping the company refine its plan for Apple Stores.

What constitutes a great board?

On the other extreme, Groupon is a case study of a poorly performing board. In early 2012 the company was embarrassed yet again when it had to restate earnings and warn of material weaknesses in its financial controls. Obviously the board has had a catastrophic failure in its basic responsibility to oversee the company's finances.

This White Paper addresses questions and challenges related to recruiting the new director to the board of a publicly held company. Yet while the focus is on public companies, many of this paper's suggestions will apply equally well to boards of privately held companies and nonprofit entities.

Before launching a search for a new board member, it's essential to look at the big picture and examine two issues that together set the stage for any recruiting effort: board size and board composition.

Board Size

The size of the board has a profound impact on its effectiveness. Boards that are too big are unwieldy. Their large size makes it difficult for the Chairperson to keep the group focused and to build consensus. Further, individual directors become less engaged because they feel their impact is diluted in a large group.

Boards that are too small face a different set of problems. They usually lack the range of expertise needed to help the company advance. In addition, their small size means fewer people share the workload, and that can put too large a burden on individual directors.

What's the right number? One study puts the average number of directors at US public companies at nine. In my opinion, a board with seven to nine members is optimal. It is large enough to provide a diverse range of skills and provide enough hands to get the work done, yet remains small enough to ensure that all directors play an active role in governance.

If the board is ineffective and size is part of the problem, define a plan to get it to a size that will deliver the desired results. Increasing the size of a board is straightforward and can usually be accomplished quickly. Decreasing the size of a board is far more complex and usually takes several years to implement.

Board Composition

A well-composed board includes individuals who bring a broad range of expertise and contacts to the table. There are some skills that are required to meet regulatory requirements (for example, you must have a financial expert), but otherwise the board has wide latitude in deciding what skill sets and backgrounds are required.

The challenges facing the business will drive what the board looks for in new directors. As a result, when defining the optimal board composition the board needs to consider what kinds of expertise it will need to face the company's current and future requirements. Some issues to consider include:

- *Functional Expertise.* For example legal, mergers and acquisitions, finance, marketing, sales, international, regulatory affairs, or fundraising.

- *Market Expertise.* This could include a background in markets currently addressed, markets to be addressed in the future, or experience in client industries.

- *Geography*. If the company is global, or if it aspires to be, it's important to have a board member with significant international experience.

- *Diversity*. Most boards strive to build a group that includes people of both genders and varying ethnic backgrounds. Studies show that diverse boards make better decisions.

- *Independence*. Compensation, audit and nominating committees must be staffed with independent directors, but beyond that the percentage of independent directors is undefined. In general, it's desirable to have a majority of independent directors.

Defining the Candidate Specification

The candidate specification is simply a written description of what the board is looking for in a new director. An effective specification is clear and succinct, and rarely requires more than one page.

A candidate specification should answer the following questions:

- *Objective*. What is the primary objective in bringing on this new director?

- *Top Priorities*. In order of importance, one to three "must have" priorities.

- *Markets*. Are there markets or specific companies that are especially desirable, or that you want to stay way from?

- *Level*. What level of experience are you looking for? For example, a functional leader, an active CEO, a retired CEO, etc.

- *Functional Expertise*. Is it important to have expertise in a particular area - strategy, sales, business development, etc.?

- *Scale*. In what size company should candidates have experience?
- *Type of Company Managed*. Should candidates have experience working in a public company, private company, venture-backed company, or some combination?
- *Prior Board Experience*. Is public company board experience required? "Yes" narrows the field considerably, while "no" presents more risk since there is no board track record to examine.
- *How Many Other Boards?* Board members who are overcommitted won't be able to make the desired contribution to the board.
- *Committees*. If the new board member is marked to serve on a specific committee, make note of it.
- *Personality*. Most boards have a distinct personality and working style, and it's important to find directors who will be compatible and work well with others.
- *Timing*. When do you want someone to join? Usually the relevant deadline is a board meeting where members will to vote to nominate the board candidate for inclusion in the proxy statement.

It's critical to invest the time to build consensus among members of the Nominating Committee and the rest of the board. If you don't, there's near certainty that the search for a new director will hit a snag when you begin to interview candidates, and it becomes clear that individual board members are looking for different things.

Conducting the Search

When it comes to conducting the search boards have two options. They can attempt to do it themselves, or they can engage an executive search firm to do it for them.

Many boards are able to find new directors through member contacts. The advantage of this approach is that it saves money, and there's a good probability of finding a new director who will be compatible with the existing group.

There are several disadvantages, however. First, conducting the search in-house puts a significant burden on members of the Nominating Committee. Second, the board sees fewer candidates because the search is focused on the narrow world of their own contacts. Finally, mining the contacts of board members often results in a feedback loop where the board continually recruits new directors who are like them.

Engaging an executive search firm eliminates the problems that can arise from doing the search in house. A good search consultant will conduct a wide-ranging search that goes far beyond the network of board members, and she will present a short list of finalists to the Nominating Committee. This process usually leads to a superior outcome. An added benefit is that engaging a third-party to conduct the search brings a measure of objectivity to the process, and appears less biased to investors.

Opportunities & Challenges

Boards often encounter similar problems when searching for a new director. Some of the most common challenges are listed below, along with suggestions on how to sidestep problems and achieve the best possible outcome.

Don't Get Star Struck. Many companies start a board search looking for a high profile, active CEO. In the real world they are not easy to attract, and they come with a major downside.

CEO participation on outside boards is dramatically lower than it was a decade ago, for two reasons. Many companies now strictly limit the number of outside boards on which their CEO can sit, and some simply prohibit it. They want the CEO focused on his own business. Second, since the passage of Sarbanes-Oxley, fewer CEOs are interested in the workload and liability associated with sitting on an outside board.

In the increasingly scarce instances when a CEO wants an outside directorship, they usually have very specific professional development objectives they want to achieve. The bottom line is that they are harder to recruit than ever.

Active CEOs also come with a significant downside. They are extremely busy, and their primary responsibility is always to their own company. If you succeed in recruiting one, they may not have as much time or be as engaged as you require.

Consider Retired Executives. Given the challenges of recruiting an active CEO, it makes sense to consider alternatives that can bring the same general management perspective to the board. One of the best is the retired executive. A retired executive offers the same wealth of experience and great contacts you'd find in an active CEO. As an added plus, they often come with significant board experience and usually have more time to devote to your business. Many of the most effective board members at Apple, like Chairman Ed Woolard, were retired.

Consider Division General Managers. Another alternative to an active CEO is the general manager of a business within a larger company. Division GMs don't usually have the star power of CEOs, but they often have much of the same experience. Many are eager to serve because they view board experience as an important part of their professional development.

Beware of "Professional Directors." There are some corporate directors who, despite marginal experience, have made sitting on boards a profession. They excel at the minutiae of board rules and administration, but have little to offer the conversation about how to advance the business. Learn to identify and avoid them.

Review Board Compensation and Liability Insurance. Most board members aren't in it for the money, but compensation for directors has risen in recent years in recognition of the increased workload and liabilities. Make sure your board compensation is in line with comparable companies. Further, directors and officers insurance must be adequate and in line with your industry. Prospective board members are keenly aware of their personal liability, and want to make sure they'll be shielded from harm.

About the Author

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