

# **Benchmarking Boards: Europe and North America**

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**Acknowledgements**

We are grateful for the participation of INSEAD Alumni and former participants of the International Directors Programme in this survey and would like to thank Boardex for the privilege of accessing their database.

## Motivation for this report

- This report surveys participants in the INSEAD International Directors Programme and INSEAD alumni for their views on governance. The participants represent a unique international sample of directors and executives experienced in governance. The sample is largely European based.
- The survey follows a questionnaire that has been developed at the Clarkson Centre for Business Ethics and Board Effectiveness by the Rotman School of Management in Canada. Canadian Governance practice is regarded as amongst the better standards in the world, if not the best. The resulting survey thus introduces a high quality benchmark for European governance practice.
- Furthermore, we also benchmark the results of the PwC 2013 Annual Corporate Governance survey which samples the views of US Directors, and McKinsey's 2013 Global Governance Survey.

## Executive Summary

- This report provides a scan of the state of European governance practice as perceived by a sample of experienced and mostly European directors
- This reports uses a questionnaire similar to that applied to Canadian directors, and thus provides a useful and high benchmark for European governance.
- We furthermore compare the answers with those provided by US directors in the annual PwC Governance Survey and by Global Directors in the McKinsey Annual Survey.
- The major conclusion of the survey is that Europe lags in governance practice behind Canada, which can be regarded as providing Europe with a high level benchmark and improvement opportunities.
- The major gaps in governance practice identified in this report are: insufficient understanding of ‘duty of care’ (toward the organization), insufficient industry experience, insufficient process skills at board level and limited evaluation practices at both board and director levels (suggesting that the pace of improvement is not rapid.).
- The one aspect where Europeans appear to do better than their Canadian counterparts is in the area of gender diversity. Canadians show more “tokenism” than the relatively more genuine effort that is developing in Europe which originated in Norway..
- Another conclusion that emanates from the study is that greater education and training would help (granted that this is, coming from us, a self-serving comment).

Progress requires awareness and good diagnosis. This report aims to contribute to in a global context where the calls for improved governance are increasingly voiced and also heard.

## **Why does Canada provide a good governance benchmark for the rest of the world?**

It's worth noting that according to ISS governance metrics – the only truly international governance rating – Canada is at the very top in terms of best practice adoption, with the US placed second, and then the European countries.

Moreover, since the launch of *Board Games* in the *Globe & Mail* and the *Board Shareholder Confidence Index* (BSCI) by the Rotman School (of the University of Toronto) in 2002, CCBE (Clarkson Centre for Board Effectiveness) has observed a dramatic and on-going evolution in good governance practices and transparency. The criteria for both of these ratings systems are updated on an annual basis in order to reflect emerging trends and to move the bar higher. Many issuers actually adjust their behaviour quickly to ensure that they remain aligned with changing expectations.

### **Comment from Ludo Van der Heyden:**

It is very important to “talk up” Canada as a great benchmark for Europe – first, as a great performer (that is news in itself), and also because it is not so far-removed from Europe in terms of language (French, English ...) and diversity (multi-cultural).

## Director Effectiveness

<b>Factor impeding Director Performance</b>	<b>INSEAD Survey Rank</b>	<b>CCBE&amp;CG Survey Rank</b>
Lack of / little expertise in the industry / sector	1	3
Acts too much like a manager, not a board member	2	N/A
Too busy with outside matters	2	1
Lack of up-to-date industry / sector knowledge	4	8
Lack of independence from management / staff	5	6
Lack of / little experience as a director	6	2
Too much managerial control	7	N/A
Lack of formal director education	8	5
Lack of respect for fellow directors	9	10
Lack of confidence	10	8

Suggestion - Might have different colors in columns – green if same/similar importance (same rank or +/-1 – blue if more important – orange or yellow if less important???)

### European Directors: room to grow and commit to the role

- European directors report three major roadblocks to attaining greater effectiveness, of which the major one is a lack of understanding of the industry/sector in which their company lies: it is indeed hard to imagine a board being effective without good knowledge of the industry or the sector in which the corporation operates.
- There are two other reasons respondents cite: i) insufficient distinction between the actions of directors and those of the executive; ii) insufficient time devoted to director duties, with directors being too busy with outside matters. It should be said that each of these aspects is worrisome on its own; however, the combination of a director interfering with management, with inadequate knowledge about the industry/sector that the firm operates in, opens the door to value destruction.
- Respondents further identify a number of other issues contributing to the board's ineffectiveness: a lack of independence from management, insufficient confidence in the role, and the need for director education.
- Lack of experience as a director was cited very frequently, but ranked relatively low in terms of impact: this indicates that lack of experience is a common problem, but possibly a low-impact one – maybe due to passivity, or due to directors not being that effective anyway?

- “Acts too much like a manager” was less common, but ranked high in terms of impact: major problems arise when this occurs (as one would expect).

### **European Directors: comparison with Canadian Directors (CCBE&CG)**

- Canadian directors believe that a lack of experience as director impedes director performance more than Europeans do, with a ranking 2 for ineffectiveness contrasting with only 6 in Europe. Canadian directors appear more convinced that the role of director requires experience.
- European directors believe that a lack of up-to-date industry knowledge impedes director performance more than Canadian directors, with rankings 4 and 8 out of 10, respectively. A hypothesis consistent with our conclusions so far is that Canadian directors have this expertise when appointed.
- Consistent with their view on the complexity of the role, Canadian directors further believe that formal director education materially impacts director performance than EU directors, with rankings 5 and 8 out of 10, respectively.
- Otherwise, EU and Canadian directors are generally in agreement with the top 3 and bottom 2 ranked director performance impedance factors. Being too busy with outside matters, lack of industry expertise, lack of respect for fellow directors and a lack of confidence impact the boardrooms similarly in Canada and the EU. The role remains a complex one to master.
- Conversely, when one looks at Europe, one might conclude “Know your role – do not act like a manager!” Managers on boards, without formal director training or experience, contribute to ineffectiveness.

### **European Directors: comparison with PwC’s Survey of US Directors and with McKinsey’s Global Survey**

- In response to the question about a wish list for new directors, ‘industry expertise’ is identified by the PwC Survey as *very important* by 48% of respondents when seeking new directors. This is in line with the views expressed by directors in Canada and the EU ranking “lack of expertise in industry” as a highly material impact on director effectiveness, and is rated as the number one issue in our EU Survey.
- McKinsey too reports that directors globally look ahead to learn from peers at higher impact boards, and to devoting more time to board work.
- The PWC and McKinsey results align with what we see in the EU survey findings with “too busy with outside matters” and “lacking expertise in the industry” ranking 2 and 1 respectively as impediments to director effectiveness.

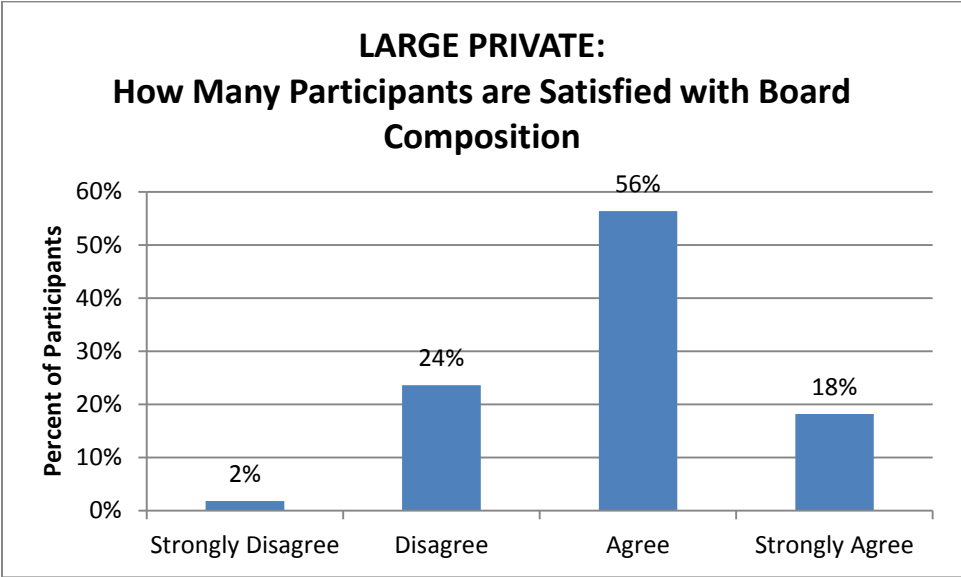
# Board Composition

## Overall Satisfaction with Composition – but is it high performance?

The respondents stated that they are largely satisfied with the composition of their boards. The replies did not vary much as a function of whether the boards represented large private, large public, SME's, or not-for-profit organizations.

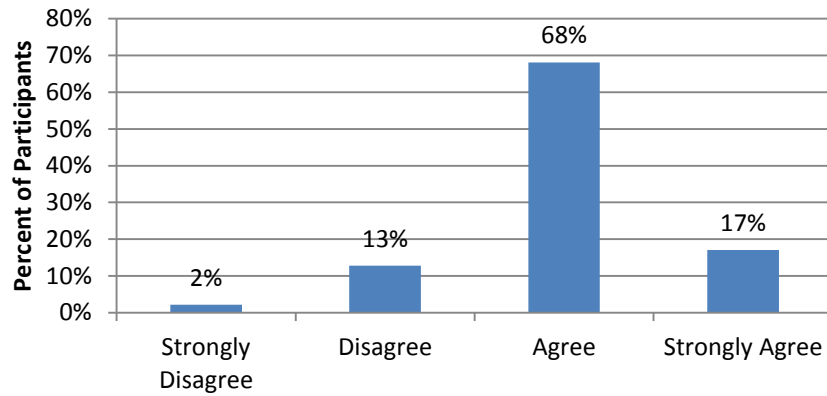
At the same time, few respondents expressed there were several opportunities for optimizing board composition. Approximately 1 out of 6 boards are described as having unsatisfactory board compositions. This was communicated most clearly by SME board members.

Most believe that their board effectively represents the interests of their stakeholder base.

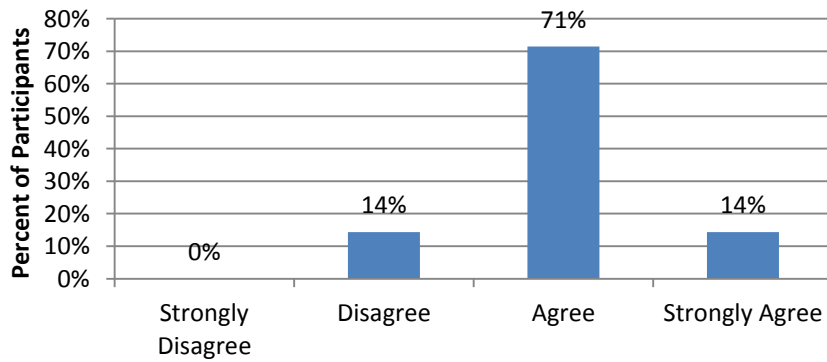




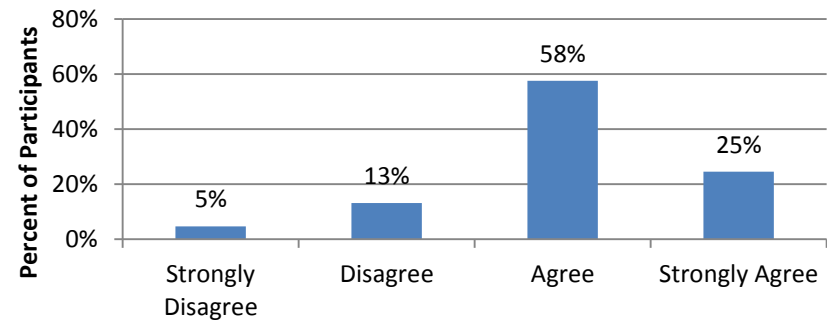
### LARGE PUBLIC: How Many Participants are Satisfied with Board Composition



### Not-for-Profit: How Many Participants are Satisfied with Board Composition

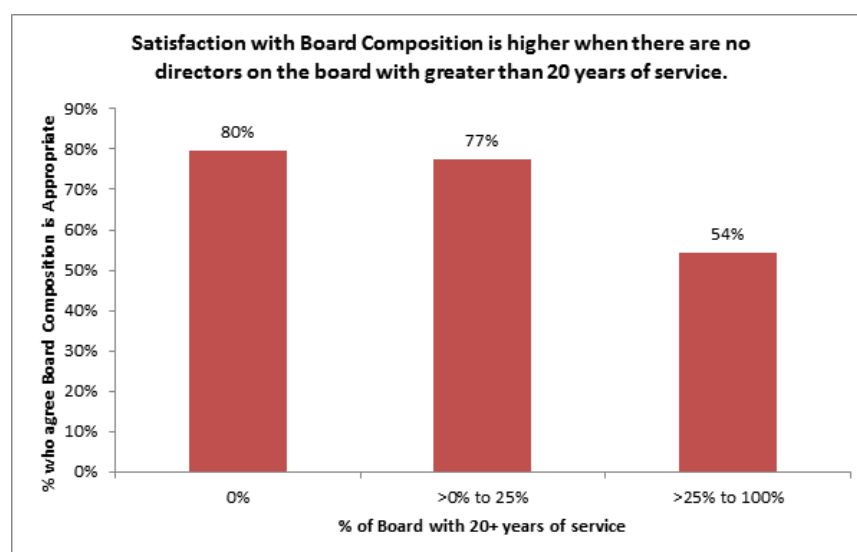


### SMALL/MEDIUM PRIVATE: How Many Participants are Satisfied with Board Composition



## Board tenure: an issue too delicate to be dealt with?

An often heard comment concerns the fact that directors are often quite old, or have served too long. The survey does appear to confirm that tenure limits (e.g. not serving more than 20 years) appear justified. Respondents express the highest satisfaction with a board composition that does not have “aged” directors, though a small minority appears fully acceptable (only a 3% loss of satisfaction). When more than 25% of the board members have more than 20 years of service, satisfaction with board composition drops markedly.



### Confirmation by PwC’s US Directors and McKinsey’s Global Directors

- “Aging has led to diminished performance:” it is the number one reason to replace a board member, as reported by the PwC Survey of US Directors. It is noteworthy that the legal context in the US forbids discrimination on the basis of age, but not on the basis of length of tenure. The survey also identifies a **lack of courage** by the board leadership as the main hurdle in addressing this issue. Domination by more “senior” board members further has a demotivating effect on the younger board members on US boards, as adding value is considered more difficult if the board is controlled by long tenure founders, CEO, etc. The younger board members then show up having lost their desire to constructively challenge the management and their fellow board members, and gradually fall into a “gently going along” mentality.
- The PwC survey further identifies the loss of independence over time as a major problem. With time, the actual organizational outcomes observed are those that board members increasingly (legitimately) identify with – causing an emotional bias in favour of actual outcomes, regardless of their relative merit. This loss of independence in judgment is considered by younger board members as a big issue.

- The McKinsey survey also identifies the desirable evolution on boards: learning from higher impact boards and board members, devoting more time to board work, and learning to deal with risk as too major issues to be dealt with more effectively in future boards.

**Duty of Care: the enduring myth of shareholder supremacy and the need for director education and training**

Overall Rank	Senior management	Employees	The company	Major shareholders	Debt holders	Minor shareholders	Community	Customers	Myself
Government agency	6	6	1	3	5	9	1	4	8
Large private (>€300m)	6	3	2	1	7	5	8	4	9
Large publicly traded	6	3	2	1	7	4	8	5	9
Not-for-Profit	3	6	4	1	9	7	2	5	8
Small/Medium private	4	3	2	1	7	5	8	6	9
Small/Medium public	6	4	2	1	5	3	8	7	9

A prevalent myth, enforced by the “shareholder revolution” that resulted in EVA becoming the measure of a company’s performance, is that directors are accountable to shareholders. Even in the US, which certainly does it utmost for shareholder rights and privileges, the law states that directors are to serve the best interests of the company, not that of the shareholders. This is a logical consequence of the fact that a corporation is a legal entity, and that as a legal entity it is responsible, and can be called to justify particular actions or take responsibility for particular actions.

There are two other reasons that shareholders are not the “masters” they sometimes are portrayed to be. The first is simply because there are many difficult types of shareholders each with different interests and time horizons: Shareholders commonly are not of the same mind.

The second argument often heard is “that shareholders pay for everything”: that statement is factually wrong! Shareholders do provide equity capital at the start of a company (or every time the company issues equity), but most of the monies that the company needs to pay its suppliers (including the suppliers of equity capital) comes from the company’s customers!

The above table confirms the need for directors to take on some training with regards to director duties of care – especially because, for the most part, rankings are pretty similar across sectors. In particular, the following points might be noted when examining the table of director replies to their duty of care:

- Government and not-for-profit, for whom minority shareholders and debt-holders are less important, owe a duty instead to the community – though the same can be said about the lack of convergence in community opinions that one makes about the shareholders of a private company.

- It is interesting to note that, if the CEO is NOT on the board, then the duty of care to management is ranked higher – which is rather counter-intuitive and surprising: it suggests that boards can be less caring of management (and of employees, presumably) when the CEO is on the board, presumably on the belief that this duty of care is now delegated to the CEO.
- Smaller companies (by number of employees) rank senior managers higher than other stakeholders, at the expense of minor shareholders.
- Single tier boards rank minor shareholders above the company and customers; but two-tier don't; the justification for this is surprising and difficult to understand. From this can one conclude that most regimes should be the company!

These results confirm biases in 'duty of care' that are real, though difficult to justify and understand. The duties of directors are to the organization, and it is important to find the most effective agreements with the organization's multiple stakeholders.

### **An issue in the news: comparing Europe and Canada on gender diversity**

This is an issue that has faced boards in Europe and Canada for a number of years now, though the issue has received more attention (including from legislators) in Europe than in Canada.

It is interesting that the level of representation by women on boards of directors is very similar between the two regions. Among our survey participants, the most striking figure is that nearly half (48%) still have no female representation at all.

The distribution of female presence on boards is different: in Canada, more boards have at least one woman director, while in Europe, more boards have several woman directors. This suggests less tokenism in Europe. It is largely agreed that single minorities on boards hardly make a difference (on the minority issue), and that in addition, this can make the position quite uncomfortable for the individuals occupying the position.<sup>1</sup>

According to Boardex, gender diversity among listed companies is quite high in some European countries: Norway at 39% and France at 22% demonstrate the impact of government quotas. Norway has been the first country to move on the topic, largely because of democratic issues concerned with a more balanced gender representation at the top of the corporate pyramid.

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<sup>1</sup> For further detail on the issue, we address the reader to the ICGI Submission to the EU Consultation on *Gender Imbalance on Corporate Boards in the EU* (May 28th 2012).

This view has been largely taken over by other EU countries, and EU Commission Vice-President Reding also has strongly argued for a European ruling on the matter.<sup>2</sup>

Our survey of EU directors shows the following:

- 48% of INSEAD survey participants have 0 women directors while only 19.7% (1 out of 5) have at least 25% women on board;
- The presence of women on boards, as reported by the INSEAD survey, participants is 14% - which is similar to the 2013 figure for the firms that are composing the S&P/TSX Composite index, which stands at 13%.

Comparative scores for Canada are:

- 38% of companies have no women directors (vs. 48% in the EU survey);
- 16% have at least 25% or more women on board (vs. 19.7% in the EU survey);
- 46% have one woman director on the board (vs. 25% in the EU survey).

If we now turn to the US with the PwC report on the state of governance there we find (on page 4) that:

- 75% of respondents feel *gender diversity* is important when recruiting directors. This outcome may be partially impacted by the scrutiny boards have been under recently to focus on recruiting more women on boards. However, *gender diversity* does rank 7 out of 10, after director skills/demographics.

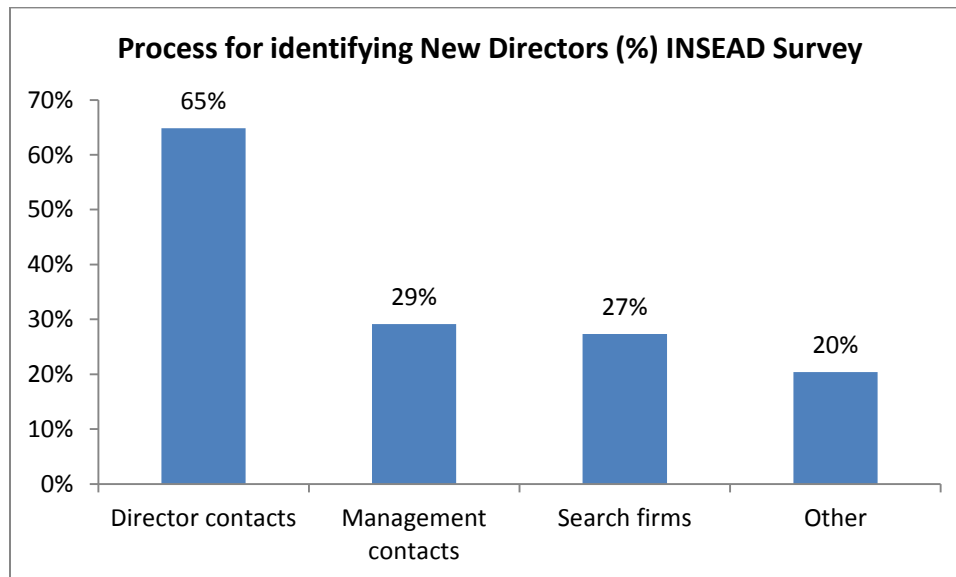
It may be worth mentioning that insights from research on the issue: female and male directors largely agree on their dislike of quota. The big difference lies in their views on how the gender difference will be bridged over time: the majority view amongst men is that this should happen “naturally,” half of the female directors agree with them, however, the other half – reflecting on the little change we have seen until regulation was introduced – has concluded that regulation unfortunately is the only answer if one is to make serious and quick progress.<sup>3</sup>

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<sup>2</sup> The EU Commission was not in favour of a strong ruling, and the matter was finally passed on to the countries.

<sup>3</sup> Again, we refer the interested reader to the ICGI Submission to the EU Consultation on *Gender Imbalance on Corporate Boards in the EU* (May 28th 2012).

## Director Nominations: a shortfall in formality and process



Confirming the informality of European board work, the majority of director nominations came in largely from directors' personal contacts and networks. Managers and search firms (in this order) came in second, very close to each other, but at approximately half the frequency.

### Comparing with Canada

It is indeed interesting to note that Canada in this regard relies even more heavily than do European boards on informal sources for board candidate identification (83% in Canada versus 65% in EU), and is thus, in that region, the most common process by which directors get on boards.

Canadians, however, are more open to and rely to a greater extent on recommendations from management (51% in Canada and 27% in EU), raising a concern for a loss of independence at board level from management. They also, as a result, are presented with a larger number of candidates when filing board positions, making the various processes more complements than substitutes. This practice then calls for greater rationality and objectivity, which has led Canadian boards to bolster their informal processes with formal ones such as skill matrices and evergreen lists.<sup>4</sup>

Compared with Canada, European boards appear to rely more on informal contacts and influence, lacking the degree of complementary formality of Canadian

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<sup>4</sup> Evergreen lists are lists of potential nominees that are maintained on an on-going basis by boards. They help ensure that there are suitable candidates at all times, including in the case of an unexpected vacancy.

approaches. The risk is that informality could become improvisation due to last minute reactive decision-making. This lack of formality and discipline in succession planning would suggest that high performing directors will either not be identified, or not be available (as typically they themselves are disciplined in board matters). This may be consistent with our earlier interpretation of satisfaction, but may fall short of excellence.

### **Board and Director Assessments: a relative performance that is outright disappointing?**

The lack of formality in European boards becomes startling when one compares Europe and Canada on board and director assessments. One might consider such assessments as pre-requisites to an enlightened nomination process. Indeed, knowing what boards are missing in terms of competences and skills focusses the search and the need to communicate awareness of director strengths – as well as shortcomings. This can only impress high quality candidates, and facilitate the recruitment and subsequent on-boarding process.

The results are as follows:

- only 19% of INSEAD survey respondents reported that their companies have formal board and director assessments as compared to 73% of the Canadian companies forming the S&P/TSX Composite Index;
- only 23% of INSEAD survey respondents have director assessments compared to 52% of S&P/TSX companies that have board assessments including director peer reviews;
- only 38% of INSEAD survey respondents have formal board evaluations compared to 80% of the S&P/TSX companies;
- And finally, INSEAD survey respondents confirm that they are more satisfied with the effectiveness of their evaluation process when it includes both board and director assessments compared to a board-only evaluation.

The differences are not anecdotal and substantiate our conclusion of a lack of process discipline and skills on European boards.

The journey to board effectiveness in Europe is thus only beginning, as there can be no confidence in a board's performance without formal review processes and benchmarks which are widely available – through auditing and headhunting firms, as well as private consultants specializing in these matters (for those boards that wish to acquire them).

## Board Processes: a glaring absence!

### Executive Sessions

INSEAD survey results of participant answers to the question “Do you hold executive sessions (or so-called “in camera” meetings) without management?” are:

Do you hold executive sessions?	In camera
Yes	32 %
Sometimes	38 %
Never	25 %
Not Sure	6 %

Comparing these answers to our Canadian benchmark is startling: 95% of S&P/TSX Composite Index companies hold at least one executive session per year!

We recall that executive sessions are a good practice to foster “open” discussions amongst board members concerning management and company issues. In the absence of management, board members more easily “speak their full mind” without creating emotional or trust issues with the management.

This practice is considered “good hygiene” so as to be able to clear away bad feelings that may have arisen amongst certain board members, or simply allowing wrong or unfounded assumptions to pester the quality of exchanges between management and board members.

### CEO Evaluation, Compensation and Succession

Evaluation, remuneration, and succession planning along with company and financial strategy, are some of the key decisions that boards make. Recourse following a bad decision is possible, but typically very costly (time, reputation, trust, etc.). As a result, directors in Europe and elsewhere are very eager to have sufficient information on these issues and processes are run as effectively as possible.

Hence, our table below is hardly surprising: European directors view formal processes (e.g. surveys or combination of written and verbal) as more effective for CEO evaluation. One might think, hearing this point, that European directors thus say the right thing, but somehow do not put “their words into action” to the extent that Canadian directors do.

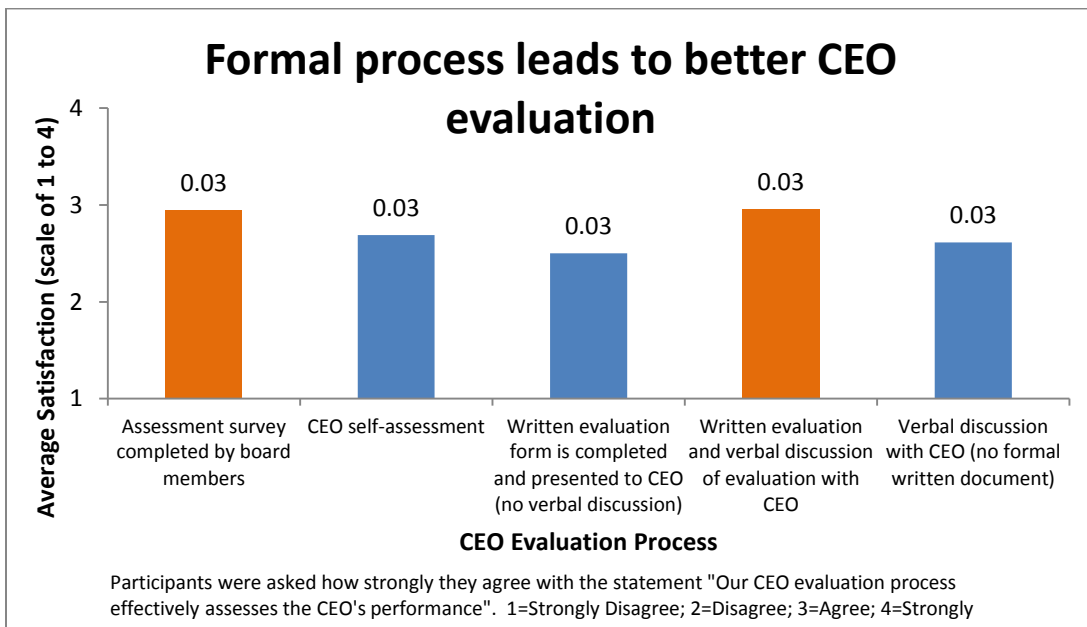
Indeed, on the subject of having a formal CEO evaluation process, for example, only 18% of all EU survey respondents confirm to have a formal CEO evaluation process, compared to 53% of the TSX Index companies in Canada. The gap continues to be startling!



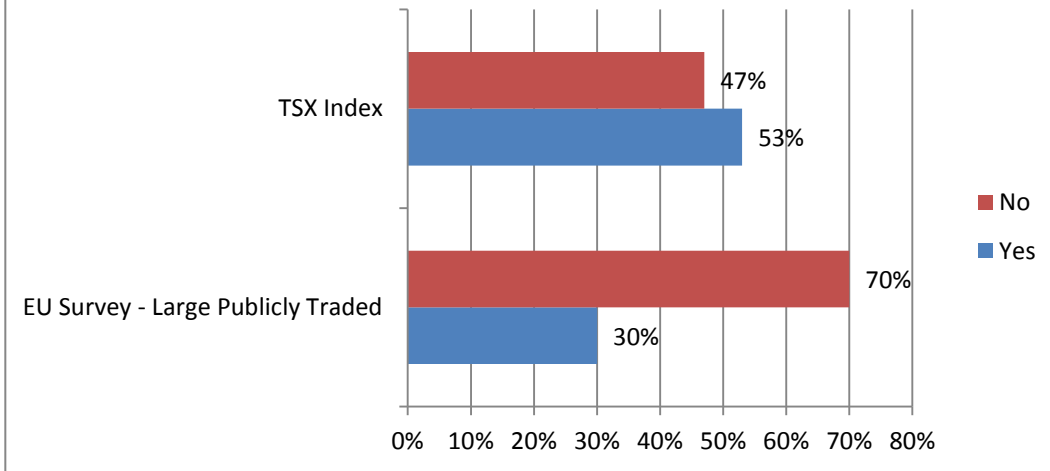
And yet, EU directors are more confident in CEO pay/performance alignment than Canadians: 72% are confident overall, and the number rises to 80% for large publicly traded companies. The comparative number for Canadian directors (who should not be considered less intelligent than their European counter-parts) is 59%! That difference is puzzling, unless one hypothesizes that European directors are over-confident and assume they can align compensation with performance – and with market benchmarks – better than they actually can. It is clear that the latter ought to engage their Canadian colleagues on their views, to validate their over-confidence, or correct it, or more simply understand why Canadian directors seem much less convinced to have found the right alignment between contribution and pay.

Of course, the answer might also be cultural: EU directors and CEO's for that matter may, to a lesser extent than their Canadian counterparts, worry about optimizing CEO compensation and aligning it truly with the actual CEO performance. If this is true, they ought to be less concerned with getting the optimal balance right, and they also would then be *de facto* more easily satisfied that this dimension is handled in a satisfactory way.

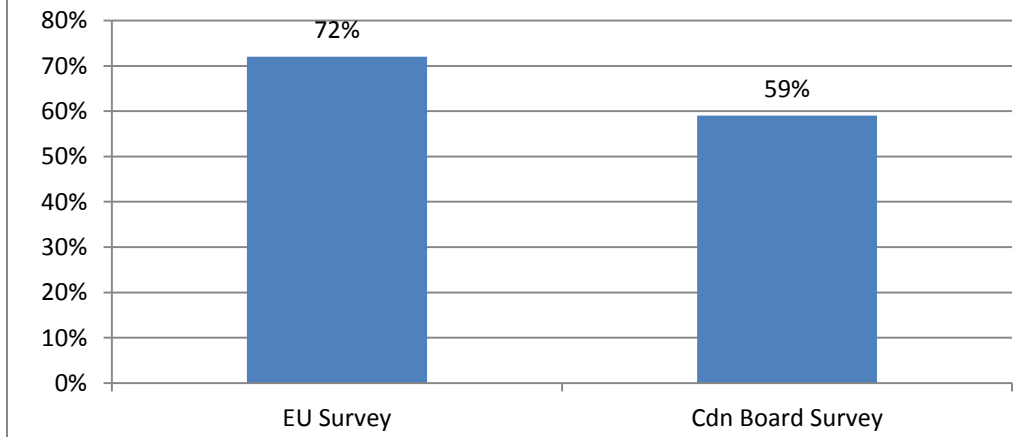
The latter interpretation is consistent with the relatively low influence that European directors attribute to compensation consultants: only 29% of INSEAD respondents indicated that they used them (for either pay amount or pay alignment).



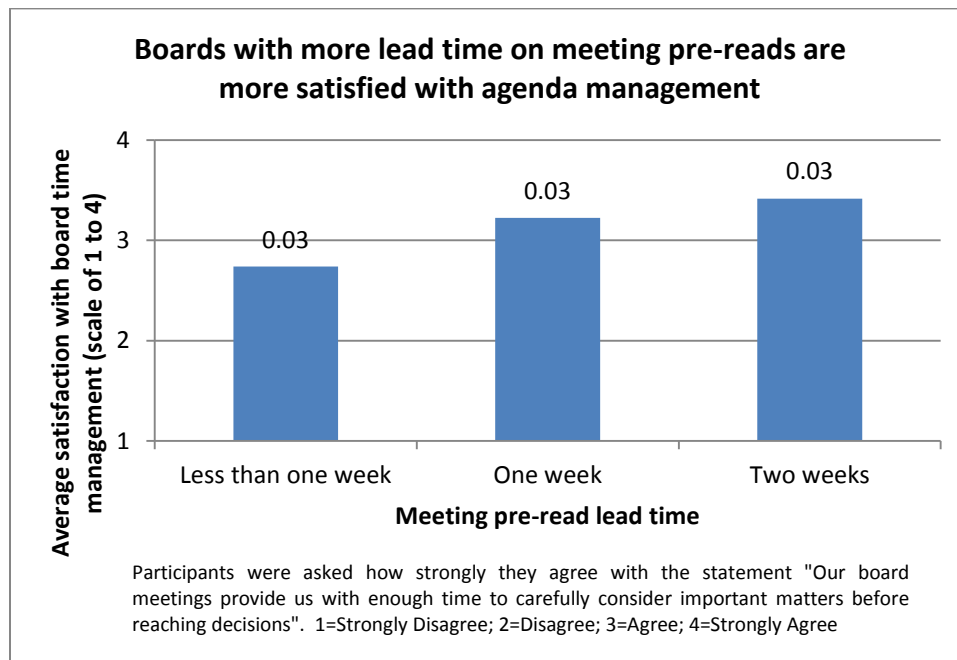
## % With Formal Succession Plan for CEO



## % of Directors who are confident in CEO pay/performance alignment

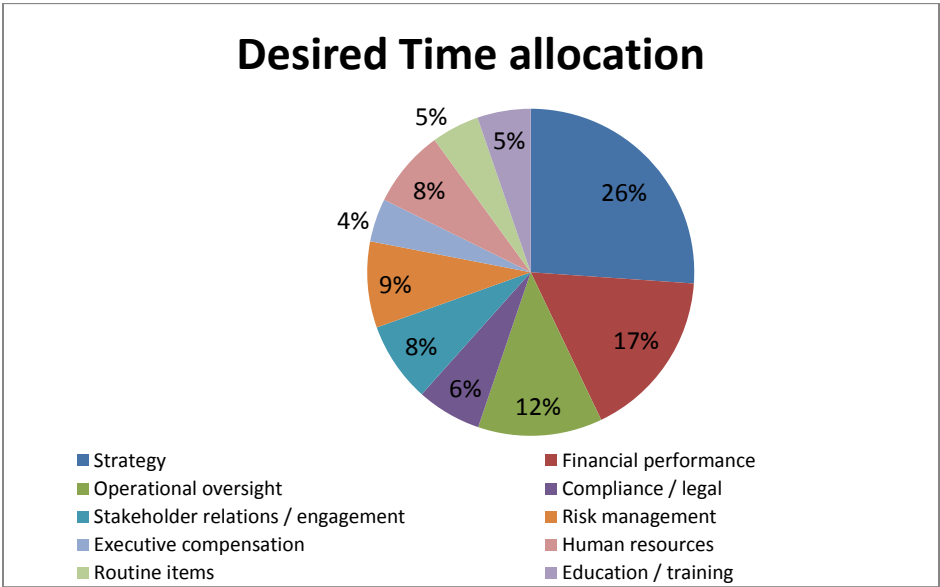
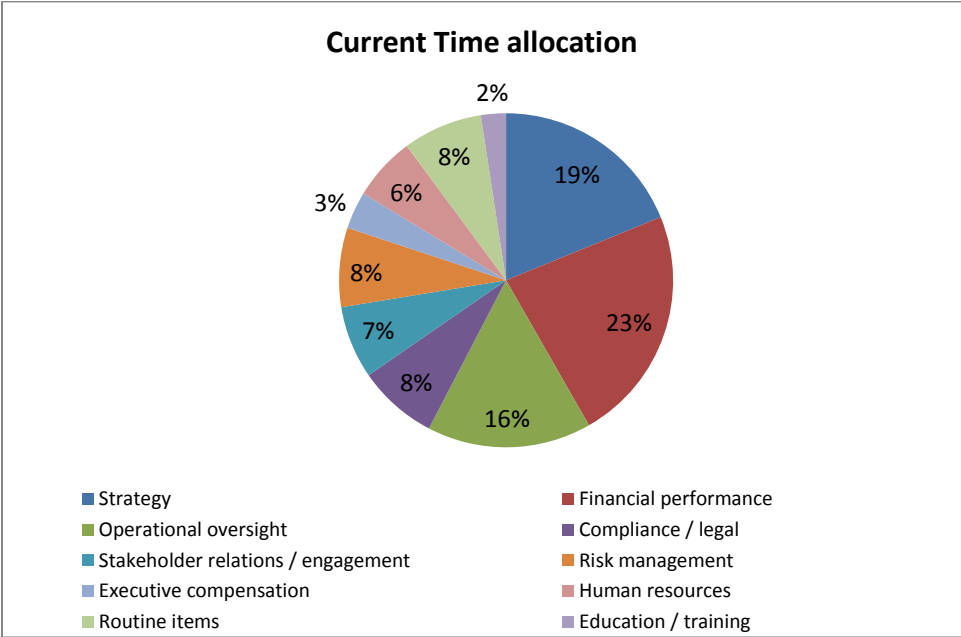


## Meetings: pre-reads and time allocation



Concern for process does in the end show up also amongst European directors: INSEAD Survey respondents indicate that time in meetings is less effective when pre-reading material for the meeting is sent less than one week prior to the meeting. Conversely, all respondents believe meeting time is effectively used when pre-reading material is sent two weeks prior to meeting.

**Time Allocation: contrasting what is with what should be?**



Another process dimension concerns the actual time allocation to processing the items on the board's agenda. The INSEAD survey asked directors for how the time was actually spent, and for their views on a more optimal time allocation.

INSEAD respondents clearly identify strategy as the item on which more time ideally ought to be spent (+7%), even though it is already the second highest time cruncher (at 19%, after finance at 23%).

Other items that would get higher priority for INSEAD directors in an "optimal schedule" are executive compensation (4% from a current level of 2%, amounting to a 100% relative increase) and education and training (5% instead of a current level of 2%, amounting to an increase of 150%).

The answers provided by directors allow us to identify where the extra time would come from: the biggest reduction would be in finance (- 6% from a current time allocation of 23%), then in operational reviews (- 4% from a current time allocation of 16%).

The Clarkson Centre survey has seen similar trends among boards in all sectors in Canada, as well as credit union boards in the U.S. Earlier US survey findings (CCBE/PwC 2009 and CCBE/Flene 2010) confirmed that directors want to spend more time on strategy: 79% of respondents of the PWC 2013 board survey want to devote more time to strategic planning, and of these, 30% stated that they wanted to spend 'much more time and focus than in the past'. McKinsey respondents were more satisfied with the effectiveness of the board's discussion on strategy, but then they had agreed to spend more time on it.

Boards are thus becoming increasingly aware of their responsibilities as strategic stewards, and have identified that better time/agenda management is one of the critical steps to achieving this effectiveness.

Boards also want to spend at least as much time on education/training as they do on routine items. This may suggest that the amount of time currently spent is highly insufficient. Essentially, if a board spends 10 hours on education and training for the year, then there is a desire to spend about 25 hours on education and training (or +150%).

More education is a good thing! Indeed, 59% of 2013 PwC survey respondents indicated that they believe all directors should be required to attend board education/training on an annual basis. McKinsey Global Directors also wish to learn from high impact boards on how to better debate strategic alternatives, evaluate resource decisions, and assess management's understanding of value creation and performance management.

In 2013 directors spent more time on education - 1 in 4 (or 25%) spent more than 16 hours in 2013, compared to only 18% in 2012. INSEAD survey respondents indicated that they desire to spend twice the amount of time on director education than they currently do. EU directors agree with their US counterparts that more time should be spent on education.