

# Seismic shift in board composition

*New opportunities for board service are opening up for next-generation leaders.*

BY DENNIS C. CAREY AND NAYLA RIZK

**F**IVE YEARS AGO, at least half of the directors of a typical corporate board were active CEOs. Highly valued for their general management experience, big-picture view, and knowledge of current business challenges, sitting CEOs were the inevitable “ideal” candidate in nearly every board search our firm conducted at the time.

CEOs themselves saw the value in serving on outside boards and made time for these commitments. Taking advantage of the opportunities to network and observe different industries through board service, chief executives of S&P 500 companies served on an average of two outside boards five years ago. Large, well-run companies had no trouble filling open seats with well-qualified CEOs.

What a difference a few years can make. While demand for new directors is greater than ever, a seismic shift on the supply side has occurred. CEOs have scaled back their participation in outside boards dramatically and today serve on an average of less than one directorship in addition to their own. Even the most well-respected companies routinely are turned down by several CEOs before they are able to fill a director position. In short, demand for new directors vastly out-

paces the supply of the most experienced, knowledgeable, and tested corporate leaders.

## A transformed role

Ironically, the primary contributor to this imbalance between supply and demand is governance reform. Intended to enhance board effectiveness and independence from management, legislation and exchange listing requirements increasing the board’s responsibility in many areas, particularly in the audit process, has transformed the role of the director. Boards and their committees

meet more frequently and for longer periods than in the past; directors also are spending a great deal more time preparing for meetings and communicating with fellow directors and corporate staff between meetings.

Given their own demanding schedules, most CEOs simply do not have the time to serve on outside boards. And, increasingly, boards are limiting their CEOs from serving on more than one outside directorship, if not outright banning outside board service altogether. This is bad news for companies, which benefit from the exposure CEOs get to other industries, business issues, and leadership styles through outside board experience.

In addition to the time demands, the increased liability, reputational risks, and media scrutiny related to being associated with a poorly governed company are turning off qualified candidates. Frankly, many of the most qualified board candidates have done the math, comparing the risks and time demands with the financial reward, and have concluded that board service isn’t worth it in today’s environment.

In response to the shrinking pool of traditional board candidates, board composition is evolving rapidly and will continue to evolve.

It was not very long ago



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that clients demanded only candidates who fit the traditional director profile — active CEOs who led companies of a similar size and complexity. They were willing to expand the pool typically only for specific purposes, such as to increase the diversity makeup of the board or to gain specific geographic or functional expertise. For example, as technology began to play a more fundamental role in corporate business models, we saw increased demand for chief information officers. In general, however, boards rarely invited functional executives to join.

### New sources

With the CEO candidate pool taxed to the limit, companies are looking to new sources to fill director positions, and executives who would have had little chance of being invited to join a board in the past are very much in demand. For example, in the immediate aftermath of the passage of the Sarbanes-Oxley Act and the implications of Section 404, many boards rushed to add executives with financial experience to their ranks, including chief financial officers. In the past two years our firm's Board Services Practice has seen significant new demand for directors meeting the Sarbanes-Oxley financial expert definition.

We also are seeing growing demand for retired chairmen and CEOs, who have valuable general management and board experience, as well as recently retired CFOs and heads of audit firms. To accommodate this change, some boards have eliminated or pushed back retirement age requirements to keep former executives on the board longer.

In general, we are seeing a greater willingness by boards to consider candidates farther down in an organization. In the past six months, for example, 35 percent of our board placements at U.S. companies have been senior functional or general management executives, including chief operating officers, chief information officers, CFOs, and business unit leaders.

Boards also are beginning to add senior human resources executives, who bring expertise in compensation, pension liability exposure, and executive pay packages. More board nominating committees are recognizing that having directors with a variety of experience and backgrounds can bring valuable perspectives to the board.

Those executives who are interested in board service should understand that the individuals sitting around the board table of the future will be very different than boards of the past. Boards will include greater numbers of retired execu-

tives as well as the next generation of corporate leadership: functional leaders and senior P&L executives. The new landscape presents exciting new opportunities for some individuals to break into board service who would not likely have gained entry in the past (see sidebar for tips on taking advantage of these opportunities).

### Leadership maintained

Governance reform, which has had the unintended effect of reducing the availability of CEOs to serve on boards, has created new opportunities for functional and general management leaders and retired executives to gain a seat at the board table. While there is a danger that future boards will be less experienced because of this trend, boards can ensure that newcomers to board service are appropriately prepared for the demands of the role by providing comprehensive training for new directors and ongoing education for all directors.

In this way, boards can benefit from the broader perspectives and specific capabilities these individuals offer, while maintaining strong board leadership. ■

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## Strategic preparatory steps

**To take advantage** of opportunities that the new board dynamics are creating, up-and-coming executives should consider the following tips:

- Discuss your interest in outside board service with your CEO. It may be too late to get the CEO's support and buy-in when you already have received an invitation. This conversation should cover the developmental benefits to the company, the potential conflicts of interest to avoid, and the types of boards and experience that would be beneficial developmentally for your position. By proactively discussing the issue with your CEO, you remove the element of surprise when an opportunity arises and you may gain a powerful sponsor who likely has greater access to information about board opportunities. Your CEO also can serve as a mentor during your early days as a director.
- Once you have the support of the CEO, discuss your interest with members of your company's board, particularly the nominating committee chair. Today's nominating committee chair typically is very

involved in — if not leading — new director searches and can provide insight about the dynamics of the selection process, the skills and experience most valued by boards, and expectations of a good director.

- Seek out P&L experience. Financial expertise will continue to be an important asset to boards, and business unit and functional leaders who have managed a P&L will be in greater demand for board service.
- Be open to serving as a director of a smaller company if you have never served on a board. Boards of smaller companies are more willing to recruit knowledgeable executives who are new to board service, providing you with the opportunity to gain valuable board experience.
- Build relationships with executives who already serve on boards as these individuals can endorse you when opportunities arise; personal contacts continue to be a strong source of board recruitment.

— Dennis Carey and Nayla Rizk