Board composition: building your dream team

Tackling board refreshment and succession planning in a rapidly changing business environment

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Board effectiveness begins with and depends on who's in the boardroom. Management looks to the board for oversight and counsel, and it's critical that the directors evaluating information and making key decisions be the right people for the company and for the moment. As companies' operating models shift and the business landscape changes, boards need to adapt in tandem, regularly assessing whether they have the right skills, experience and diversity of thought for the future direction of the company, and refreshing the board as needed.

Directors should regularly examine who sits on the board. The board's composition changes as directors retire or leave for other reasons, and board members should have a robust succession planning process to identify the right individual to fill an open seat. Too often, the replacement of a director is done in an ad hoc manner without making a thoughtful and comprehensive review of what the board needs.

Boards today are feeling pressure to make refreshment a priority. Shareholders are increasingly scrutinizing board composition — asking whether the current makeup is best suited for today's strategy — and some will even vote against individual directors if they feel they have seen too little progress toward reshaping the board.

Nominating/governance committees, who often take the lead in assessing and managing refreshment, should assess board skills, consider board refreshment, identify gaps and plan for succession, ensuring that these processes are robust and occur at least annually. The full board also needs to be engaged and weigh in so that there is an overall agreed-upon plan to achieve the optimal board composition.

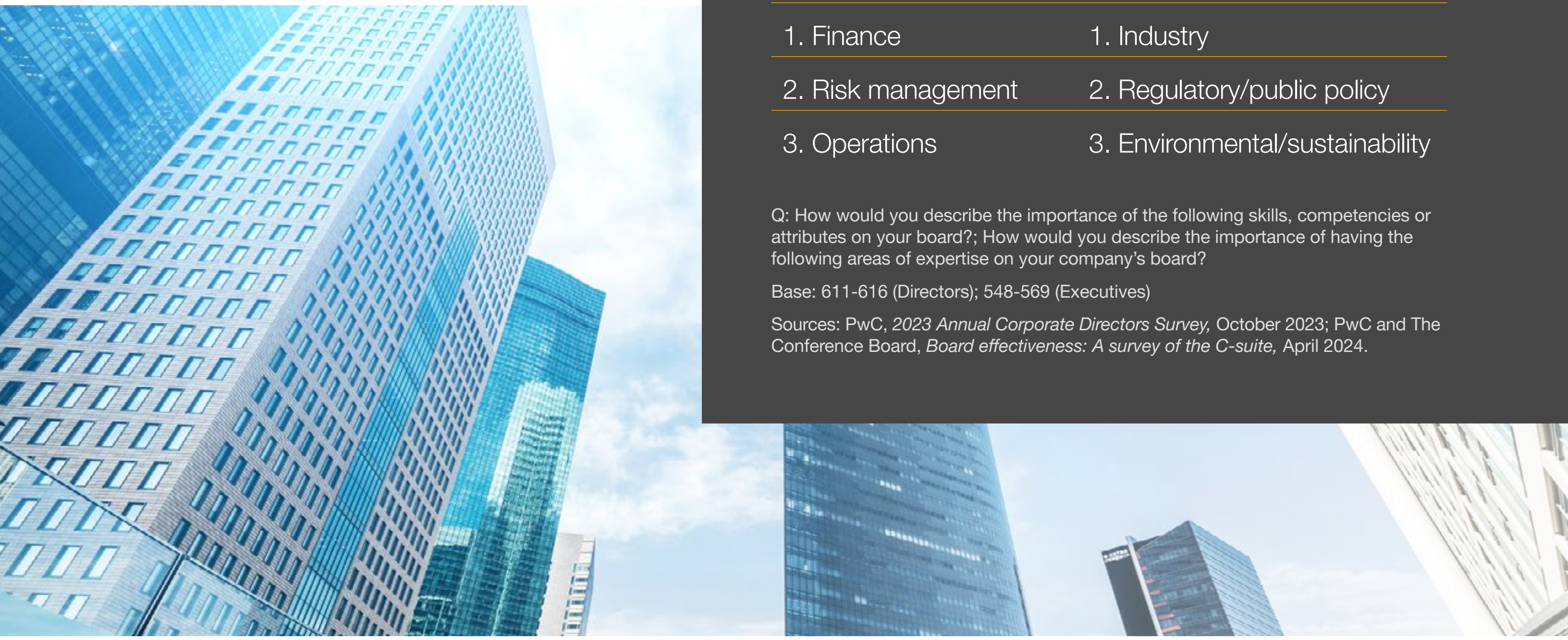
Assess board skills and attributes

A board of directors is, of course, dynamic rather than static. The board is an assemblage of skills, experience, personalities and perspectives that must continuously adapt to the changing business environment and the company's shifting strategy. Boards bring on new members not only for their current expertise but for their ability to learn and continue to add value, both individually and as part of the team.

Boards need to work to align their blend of skills and attributes with the company's long-term strategy, asking themselves: What would the ideal board look like to support the company's strategy? Input from management on the skills and experience leaders value at the board level can also be helpful.

What are the skills most important to have on boards today? In PwC's most recent *C-suite survey on board effectiveness,* only 28% of executives said they feel their boards are armed with the right combination of skills and experience. Our survey also shows a wide disparity between executives and directors on the importance of having specific areas of expertise on their board. While executives prioritized industry, regulatory/public policy and environmental/sustainability expertise as their top three competencies, directors prioritized more traditional board oversight areas such as finance, risk management and operations.

The board should consider not only skills and expertise but other attributes such as diversity of perspectives. Diversity goes far beyond gender — it can mean race, ethnicity, age and even geography. A diverse board can generate different questions for management, and a broad spectrum of thought and perspectives can benefit overall decisions.



Differing views on expertise needed on the board

Directors	Executives
1. Finance	1. Industry
2. Risk management	2. Regulatory/public policy
3. Operations	3. Environmental/sustainability

Q: How would you describe the importance of the following skills, competencies or attributes on your board?; How would you describe the importance of having the following areas of expertise on your company's board?

Base: 611-616 (Directors); 548-569 (Executives)

Sources: PwC, *2023 Annual Corporate Directors Survey,* October 2023; PwC and The Conference Board, *Board effectiveness: A survey of the C-suite,* April 2024.

A *board composition matrix* can help lay out the board's knowledge, skills and backgrounds — and can be helpful in determining what's lacking and/or missing on the board today. With investors increasingly asking for transparency and disclosure on the board's composition, many boards voluntarily offer this information in their proxy statements.

When evaluating the board's skills, the objective is to compare the current directors' suite of attributes with those matching the company's future. Identify any gaps and incorporate this information into a plan to move the board toward an ideal makeup, aligning expertise and experience with strategic goals and business trends.

Nearly three-quarters of companies in the S&P 500 disclose a director skills matrix in their proxy statement.

Source: Spencer Stuart, *2024 U.S. Spencer Stuart Board Index,* September 2024.

Some boards may decide to expand in size to add a director with a specific skill set or to bring more diversity. This can be a short-term solution to meet the ideal board makeup until a director seat becomes available. Boards must consider their optimal size: small enough for efficiency but large enough for committees to discharge their responsibilities.

Does the board need deep, technical expertise?

Since boards have a finite number of seats, the question of whether a seat should be filled with someone who has only deep, technical skills but not broader business acumen is one that is determined by each board based on the company's industry, strategy and risk profile. The board must strike the right balance of the skills it needs based on the various topics it oversees.

Adding a director with deep but narrow skills poses two key risks:

- The director may struggle to contribute to other board agenda topics. In this case, the candidate should have both specialist knowledge and broad business and leadership experience to contribute meaningfully to other areas of board oversight.
- With an expert on the board, other directors may be less willing to voice their opinions on the subject. Ultimately, board decisions are the responsibility of the entire board, so all directors need to consider how they are upskilling themselves to gain understanding and actively engage in decision-making.

An alternative to adding a director with specialist skills is to upskill the existing board or committee members. This can be done by having management deliver board education sessions as well as by hearing from external parties or organizations on the topic and attending external training programs.

Tackle director tenure

Many boards look to mandatory retirement ages to spur refreshment. A smaller number of boards use term limits. But the keys to successful board refreshment are fostering a healthy attitude toward board tenure, guiding director expectations, and conducting effective board, committee and individual director assessments.

Tenure-limiting policies For S&P 500 companies

67% have a mandatory retirement age

9% have term limits

Source: Spencer Stuart, *2024 U.S. Spencer Stuart Board Index,* September 2024.

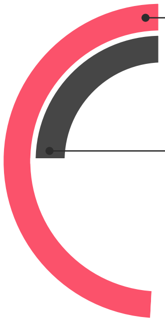
Board leaders should work to instill a culture that encourages directors to think of tenure as earned. They should set the tone about the length of director service and make that clear during the nomination process. Board members should not assume they will be renominated for service each year — rather, service must be earned with high performance and continued alignment with the company and board composition strategy.

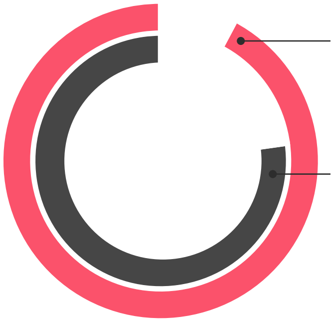
Nominating/governance committees should consider overall director tenure on the board. This is an area in which investors may be particularly interested. The committee should seek to balance fresh perspectives with institutional knowledge, looking to stagger board member turnover. A leading practice is for leaders to think of the board as one-third recently arrived directors, one-third with medium tenure and one-third seasoned veterans; this can help with succession planning.

Take action from board assessments

Regular board assessments are valuable tools — if they're used effectively. Board, committee and individual director assessments can help the nominating/governance committee understand what skills are lacking, whether training or coaching is needed at the board or individual director level, and if individual directors have the essential skills and experience for the strategic challenges facing the company. The assessment process can help identify opportunities for improvement and needed changes, with the goal of optimizing overall board composition.

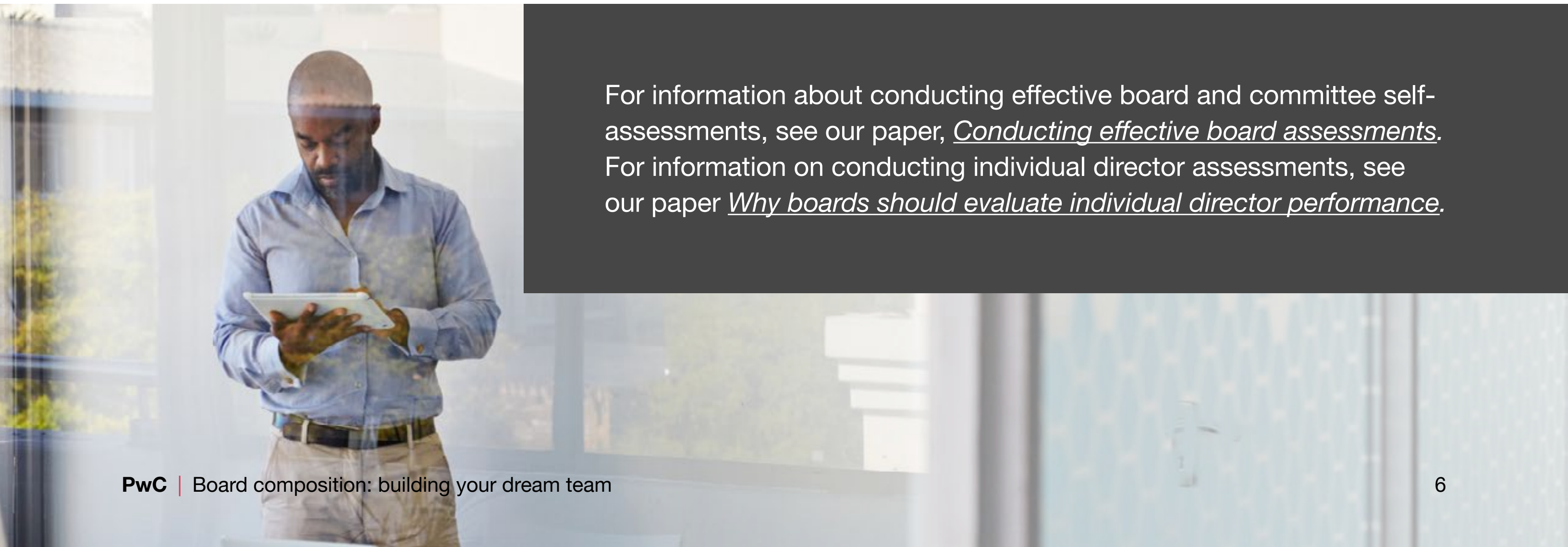
Directors and executives call for changes in board composition





Sources: PwC, *2024 Annual Corporate Directors Survey,* September 2024; *PwC and The Conference Board, Board effectiveness: A survey of the C-suite,* April 2024.

In our surveys, directors routinely cite an ineffective assessment process and board leadership's unwillingness to initiate difficult discussions about stepping down as two key obstacles to board refreshment. While 58% of respondents to our *2024 Annual Corporate Directors Survey* say their boards are taking action based on assessments, only 9% reported that their board assessment process resulted in the decision *not* to renominate a director. In other words, too few boards are using assessments to drive board refreshment. Only 45% of executives surveyed in our most recent board effectiveness survey trust their boards to remove underperforming directors.



For information about conducting effective board and committee self-assessments, see our paper, *Conducting effective board assessments*. For information on conducting individual director assessments, see our paper *Why boards should evaluate individual director performance*.

Develop a succession plan

Nominating/governance committees should adopt a multiyear perspective toward director departures, proactively planning for expected and unexpected vacancies in the boardroom. It's ideal to take a three-to-five-year view to properly plan and not fall back on an ad hoc approach when a director retires. And, of course, the nominating/governance committee needs a contingency plan for unforeseen departures.

Building on the director skill matrix and focusing on optimal board composition, nominating/governance committees should develop a succession plan that considers board roles (including leadership and committee membership), board tenure, expected retirement dates and other relevant factors. Planning far ahead allows time to recruit the right candidate with the right skills and incorporate a transition period.

Succession planning should place emphasis on the board and committee chairs, making sure there is ample time for transition and the ability to fill a seat quickly when an unexpected departure occurs. Nominating/governance committees will also want to pay close attention to regulatory requirements. For example, SEC rules require the audit committee to include at least one *qualified financial expert* (or disclose why the committee doesn't have one); if the board's resident financial expert departs, suddenly or otherwise, an immediate replacement plan needs to be in place.

While the nominating/governance committee is primarily responsible for succession planning, the full board should understand, review and agree with the plan. The plan also should be reviewed and updated at least annually.

Recruit to close gaps

With a comprehensive assessment of the board composition and known vacancies, nominating/governance committees are equipped with the necessary information to create the desired director profiles to fill open board seats. It's important to recognize that one candidate may be unable to fill all the board's needs. The nominating/governance committee will need to prioritize its needs to identify realistic candidates. The goal: to have in place a slate of candidates whose skills, experience and character can address gaps and opportunities to meet the company's strategic needs in the years ahead.

Regarding recruitment, all directors should be part of the pipeline strategy, teeing up potential candidates. But recruitment needs to look far beyond board members' contact lists — looking at director search firms and other relevant organizations for potential candidates. The nominating/governance committee is generally responsible for keeping a running list of potential director candidates and cultivating relationships with them for future board service. By actively engaging with prospective candidates over time, the committee can better assess not only whether they meet the necessary qualifications but whether they would be a good cultural fit.

Cultural fit matters

When evaluating potential board members, it is essential to consider how they will integrate with the existing board culture. Successful board dynamics hinge on effective collaboration and productive working relationships. The nominating/governance committee should assess candidates not only for their qualifications but for personal characteristics and potential to contribute to a cohesive and effective team. Our publication *Why good boards make bad decisions: Four factors undermining board effectiveness* delves into the significant impact of interpersonal dynamics on board productivity and decision-making.

Provide transparency to stakeholders

Increasingly, large investors, proxy advisory firms and other stakeholders are paying close attention to board composition and want to better understand the board's approach to refreshment. Many investors and proxy advisory firms have also adopted policies to expressly support board diversity; some are even looking to vote against nominated directors or nominating/governance committee chairs or members when they see diversity as lacking, director tenure as overly long or the board refreshment process as less than robust.

The nominating/governance committee should work to stay updated on stakeholders' evolving views on, and interest in, board composition and refreshment.

Conclusion

Who's on the board holds immense importance. Board composition, in terms of both individual and collective quality and decision-making ability, directly influences board performance and long-term shareholder value. A board that proactively assesses its skill sets, addresses director tenure, incorporates outcomes from board assessments and plans for succession can help guide the company toward future success. Directors have the power to make real change happen — and enhance effectiveness when it's needed most.

How PwC can help

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC's Governance Insights Center.

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