The last number of years have been a proving ground for companies and it is important that we learn from the difficult times and use the knowledge gained to make sure that we make the most of the recovery as it strengthens. With this knowledge we can shape the composition of the boards of businesses to ensure that they prosper and are better placed to weather the impact of future downturns more effectively.

One of the largest international law firms, Eversheds, has used its extensive client base and professional contacts across the globe, including a variety of sectors and industry bodies, to research one of the possible factors affecting the achievement (or not) of success during the financial crisis, namely, the composition of the board.

In conducting their research they wanted to understand how well prepared boards really were to deal with the challenges that arose during the financial crisis and in addition, to try and identify what differentiated the more successful companies from the rest. The findings make thought provoking reading and add to the ongoing debate into the board, its role and responsibilities.

The Research

The research, undertaken an independent research company in 2012, investigated the share price performance of 542 of the worlds largest companies. Although the research was targeted at listed companies it is believed that the findings are equally relevant to privately owned businesses.

In addition to looking at share price performance and company success before, during and after the financial crisis, the survey also investigated the correlation such share price performance had with the composition of the board looking particularly at size, diversity, independence, skills mix, experience and longevity of service.

The researchers also interviewed 80 directors selected at random from the companies surveyed. These directors were asked for their opinions on board role, board composition and board effectiveness. The findings were then analysed both by region and by industry sector.

Key Findings

The key findings from the Eversheds Board Report can be summarised simply as smaller, independent and diverse boards do better.

Smaller Boards Do Better

Better performing companies tended to have fewer directors. This was shown to be particularly true for companies in Hong Kong, the US and Continental Europe. In the sample group, boards had between 6 and 32 directors with those in Continental Europe having the largest average number of directors at 18.7. Directors interviewed were largely unsurprised by this finding, noting the benefits of smaller boards (in descending order of mentions) as:
Impact of Board Composition on Company Performance

- greater focus on the key issues
- better management from the chair
- quicker decision making
- better overall dynamics between board members.

Independent Directors

There was a positive correlation between share price performance and the number of independent directors on company boards. In this context ‘independent’ means directors who have little or no direct sector specific experience. Directors interviewed marginally preferred independence to experience when asked to make a choice although a majority (67%) said that both were important when putting a board together.

In particular many executive directors said that they had not experienced such difficult economic conditions before and therefore had placed greater value on the skills and experiences of the non executives.

Better performing boards had a higher proportion of executive to non-executive directors with the average composition ratio at just over 22% (executive directors).

Diverse Composition

Most directors believe that diversity is correlated with better performance. The type of diversity most sought after is experience and sector rather than age and gender.

Nevertheless, another finding from the research was that a higher proportion of female directors also tended to be associated with better performance. While the findings showed that companies whose boards had a higher ratio of female directors did perform better, opinion was split about whether diversity for its own sake was beneficial for board performance. Less than half of directors interviewed (who positively thought that diversity was a good thing for its own sake) were directly in favour of taking positive action (through the introduction of quotas or similar) to place more women on boards.

Additional Findings

Other points of interest coming out of the Eversheds Board Report include:

- having a serving CEO of another company on your board appears to be an asset
- boards whose directors held a number of other directorships had a negative impact on share price performance
- better performing companies were significantly more likely to have a higher incidence of shareholders holding a substantial shareholding (3% or more)
- generally speaking the findings apply across sectors and geographies
whilst greater engagement by the NED’s was encouraged, this did lead to tensions and a blurring of roles.

Optimal Board Composition

Firstly the report confirms that the chairman’s leadership is crucial to set the tone of the board, to drive the company’s culture and values and to ensure its integrity.

Whilst it is always dangerous to generalise, the findings suggest that the ideal board would be made up of 11 directors. Two of these would be executives (typically MD/CEO and CFO) and nine non-executives; at least two would be female; two non-executives would have industry experience and seven would be independent. The average age of director is around 60 years with 6.7 years service. Better performing companies tend to have younger (2 years younger) and longer serving directors (over 5 years).

It should, of course, be noted that the research centred on some of the worlds biggest companies, all of which are listed on a publicly traded exchange. As such it is difficult to draw direct comparisons, in particular regarding the size of the ideal board, with smaller, non listed, businesses. Having said that the general finding that smaller, independent and more diverse boards tend to operate more effectively is equally applicable to all companies in all sectors and geographies.

Director’s Feedback on Challenges

Over half of the directors interviewed (60%) thought that the substantive role of the director has not fundamentally changed as a result of the financial crisis. The current focus is now on how that role is performed. Every director agreed that the role of the non-executive director has become more intense. Today the top two expectations of the NED’s are to spend more time looking at the company’s financials; and gaining a thorough understanding of the company’s business.

The directors identified the following challenges facing company boards (in descending order of mentions) as being the things that keep them awake at night:

- Growth strategy
- The economic climate
- Risk strategy
- Regulation
- HR strategy and talent retention
- Effective board functioning
Other issue and consistent with the 2011 report are:

- The need for the executives, not the board, to manage (day to day) the company
- Too much regulation interfering with the board’s activity
- Focusing on long term strategy and resisting short term market pressures
- Appointing the right management and board team
- Proving their own value/contribution to the company
- Succession planning.

Also the report concludes that the media have over stated the “shareholder spring. It finds that positive dialogue between shareholders and boards is more evident e.g. average AGM approval for executive remuneration packages was over 90%.