Evaluating board skills

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A board skills matrix can be a useful governance tool and is valuable to investors

Investors are focusing on board composition to evaluate whether directors possess the skills, knowledge and experience necessary to oversee the business in line with the company's strategy. Disclosure of a board skills matrix can help investors make such evaluations and reassure them that the board has a robust process in place to assess the mix of skills and diversity it currently has and/or is looking to achieve.

The skills matrix typically represents a visual snapshot of experience and qualifications for the directors to be appointed at the upcoming annual meeting. Although director biographies include individual qualifications, the skills matrix is becoming more common and a more efficient tool to depict the overall expertise and help assess boards.

Key disclosure item

Morrow Sodali's latest Institutional Investor Survey shows that the board skills matrix is viewed as a key disclosure item by investors representing $18 trillion of assets under management – 78% of respondents – when voting on director elections.

It is not only useful for investors to determine whether the board comprises the necessary skills and expertise to deliver long-term value, but is also useful for companies when evaluating the merits of a new board member. Although the topic of diversity initially started with a focus on gender, the discussion has now evolved to an overarching belief that there should also be diversity of skills and expertise.

“A skills matrix helps to identify the current skills, knowledge, experience and competencies of the board”

There is no doubt that the best examples of skills matrix disclosure are offered by US companies, which consider Securities and Exchange Commission requirements, and Australian companies, for which the corporate governance code has suggested disclosure of a skills matrix since 2014. In the same year, the Council of Institutional Investors surveyed its members for examples of what they considered best-in-class disclosure of director nominee qualifications and skills from 2013 US proxy statements, and why, and published a best practice market sample.

There is no standard for skills matrices and companies providing such disclosure use different forms, such as schematic tables, which name and list relevant director skills, and short narrative descriptions of each director’s skills.

Integration tool

The board skills matrix can be used as an internal tool to integrate board evaluation and succession planning. Although disclosure of the board skills matrix is important to investors, as it offers better insight into board composition, it also represents an extremely useful internal tool for the board to determine its optimal structure.

A skills matrix helps to identify the current skills, knowledge, experience and competencies of the board, as well as any gaps in skills or competencies that could be addressed in future director appointments.

To be beneficial, the board skills matrix needs to result from a well-thought-out and regularly reviewed process, which is tailored to the unique circumstances of each company, considers both current needs and future scenarios, and is not executed as a mere compliance exercise.

Identify skills gap

A board skills matrix should be closely aligned with other governance information, and be fully integrated into renewal and rotation policies, board evaluation and succession planning. Producing a board skills matrix can also help boards assess their own effectiveness and identify areas for potential improvement.

The skills matrix can be standardised for each company since it is linked to the company type, business model, and strategic objectives. It is, therefore, a more complex process that relates to board evaluation, in that it is possible to identify potential skills gaps on the basis of companies’ strategic choices that can eventually be filled during the process of appointing new directors.

In other words, the board must identify the key qualifications and experience essential for the company’s business strategy and expected future business needs.

It follows that there are some expertise areas which tend to be represented on listed company boards, such as legal, governance, risk management, leadership, finance, and international experience.

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There are also other core competencies which are closely linked to each company type (for example, climate change or environmental, social and corporate governance for energy and oil companies) and the issuer's specific goals.

Skills matrix disclosure requires companies to find an appropriate balance between providing valuable information to their investors and avoiding details that could be negatively perceived by the market.

Nevertheless, openness about gaps in desired skills can indicate the board proactively seeks to improve its composition and effectiveness. As such, discussion around board, committee and directors' skills matrices should be considered an important topic when engaging with investors.

Robust evaluation

A robust evaluation process can inform directors, give them a voice, and reassure a wide array of stakeholders that the board is representing their interests effectively. By providing early warning of constituents' concerns, the board evaluation process can also help directors and management understand and deal with problems before they reach the stage of open confrontation.

Board evaluation is best corporate governance practice. The existence of a robust process enabling the board to assess its own composition and effectiveness is seen as an indicator of good governance by investors.

Reassure investors

Disclosure of the board evaluation process and its outcome helps to improve investor confidence in the company's ability to address efficiently issues relating to board composition and succession planning. It is therefore crucial that higher levels of disclosure beyond the bare minimum facilitate an identification of strengths and weaknesses within the board, as well as the definition of necessary steps for improving the quality of its composition or the quality of board debates.

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The annual board evaluation has rapidly progressed beyond a pure compliance exercise, becoming a key barometer for shareholders in assessing board functioning and progress. Our Institutional Investor Survey shows that 85% of investors consider the disclosure of summary findings and recommendations to be crucial, and 78% consider the action steps and implementation timetable to be essential.

Because board evaluation is virtually unregulated, companies have a great deal of flexibility over the process and its disclosure. Therefore, it is not uncommon to find very low levels of disclosure on governance practices, or the use of generic definitions in the annual report, especially among non-blue-chip companies or in less-developed countries.

Improve effectiveness

A well-designed evaluation process is an essential tool for the board to clarify roles and expectations, as well as to prompt ongoing improvements. Broadening the scope of the evaluation by incorporating the perspective of senior managers, who regularly interact with the board, as well as directors’ peer reviews and board chair reviews can contribute to the quality of the review.

An adequate board evaluation process should necessarily include a review of board and committee composition and process, the interaction among board members and between CEO and chairman, and a robust analysis of the quality of the supporting material.

Discussion on how board skills and performance are reviewed and refreshed should be considered an important topic when engaging directly with investors. Indeed, BlackRock’s priorities for 2017 are evidence of the growing importance of this topic among top institutional investors.

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