

Time for change

Recruiting for Europe's boardrooms



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Introduction

The call for greater diversity finds common ground among Europe's leaders as boards evaluate the profiles, recruitment and support of non-executive directors





In the current global economic climate, establishing competitive advantage is a crucial part of expanding any business. At the heart of every business is the boardroom - the central hub of strategic thinking. While Europe's boardrooms are far from uniform in structure, they have, in recent years, shared growing concerns about ensuring the best composition and representation to maintain such an advantage. There is now a growing sense that board recruitment needs to be shaken up.

Across Europe, attention has been focused in particular on the under-representation of women on corporate boards, a topic that has dominated the debate on boardroom recruitment in recent months. European Commission (EC) statistics show that, in January 2012, women occupied, on average, just 13.7% of board seats for the largest publicly listed companies in European Union (EU) Member States. This represented a 1.9 percentage point increase from October 2010, compared with a long-term average rise over the last decade of 0.6 percentage points per year. The increase can be attributed to pressure from the EC and the European Parliament, as well as a number of national legislative initiatives to improve the representation of women on corporate boards. Nevertheless, overall, change remains slow, and an initial flurry of female appointments to non-executive director positions appears to have stalled.

While gender is far from the only issue that needs to be considered, across Europe, there is a widespread tendency to view boardroom appointments as a "closed shop," where only candidates who have already served on boards are considered and personal networks are the primary tool used in recruitment. These factors work against efforts to broaden the base of experience and skills on company boards in order to equip them to meet the complex challenges of the modern business world.

Perhaps these efforts would be more widely successful if all boards asked themselves one key question: is this a risk and compliance issue, or is it about realizing the business benefits that come from engaging a more diverse range of individuals?

But the difficulty of altering the existing mindset and the assumptions behind boardroom appointments has also become apparent. EY's research - conducted through interviews with board members, headhunters, business leaders and advocates of corporate governance - shows the need for fresh, innovative thinking in the process of making appointments.

This report is part of our commitment to help businesses ensure they have strong board oversight and provide transparency in order to support the effectiveness of capital markets. We hope you find it stimulating and engaging, and that it will help foster debate on this important topic.

Julie Linn Teigland, EMEA Accounts Leader, EY

"Board recruitment in Germany is very closely networked and [amounts to] a closed circle. It is hierarchical, and the role of the chairman is critical. There is a clear shortage of female candidates. The level of professionalism also falls short, and there is growing pressure from shareholders to make board composition reflect the needs of the business."

Dr. Mathias Hiebeler, Managing Partner and Joint Head of Board Practice, Heads! International



A case for change – the recruitment process

“Personal networks still fill boardroom roles. [In Italy] few headhunters are yet involved in the process. In particular, it has not been easy to find women – not because they weren’t available, but because there has been a sudden surge in demand for them.”
Marco Reboa, Board member, Carraro, Interpump, Luxottica and Parmalat, and Chairman, Audit Committee, Indesit-Hotpoint SpA

The business world is continuously changing. The aftershocks of the financial crisis that began in 2008 are still being felt, while the impact of emerging markets and digital media bring both opportunities and challenges. And yet, in the face of these and other disruptive factors, Europe’s boardrooms seem very static. In terms of age, gender, professional qualifications and means of recruitment, non-executive directors are alarmingly homogenous. Yet, there is more awareness than ever, both of the dangers inherent in “groupthink” at the top of businesses and of the need to better understand and reflect customers’ wishes.

While Europe has been successful in bringing the issue of gender diversity to the forefront of global debate, the recruitment methods used to fill boardroom positions have hardly changed. Across the continent, personal networks abound as the dominant method for the identification and recruitment of candidates for board jobs. The UK stands out as having the most process-driven system of appointment through executive search firms (also known as headhunters). But Germany and Italy, for example, remain highly networked, making the pool of likely candidates both predictable and limited.

In the UK, FTSE 100 companies rely on both networks and a formal headhunting process, but our survey suggests that it can often be difficult to tell where one process ends and the other begins. Headhunters are briefed and retained by their client, and often have long-standing professional relationships over many years with the chairman for whom they are conducting a search. There are no restrictions on the duration of such agreements, and no formal restrictions

13.7% 40%

Proportion of female board members in large EU companies

Proposed quota of female board members in the EU

on using the same firm for board appointments as well as board evaluation. It could therefore be argued that the system of appointments itself is in danger of reinforcing existing thinking within the boardroom, particularly as it filters down from the chairman.

“Greater diversity in boardrooms will be achieved when business leaders make bold choices and step out of their comfort zone. We cannot leave it to the search firms; it will take hand-to-hand combat, identifying talented candidates and grooming them, and then matching them with appropriate positions.”
Ruby Sharma, Leader, Americas Audit Committee Center, EY

One aspect of the recruitment process for Europe’s boardrooms that prompted an almost unanimously positive response in our research was the use of advertising for boardroom positions. The attraction was felt to be twofold: transparency and the potential to attract a wider pool of talent.

On the negative side, there were fears expressed that advertising might be merely a “token” effort when, in reality, a likely candidate had already been identified and a decision taken. There were also concerns that (based on the current example of advertising for public sector jobs, for instance) a great deal of work would need to be done on job specifications in order to attract the right individuals. However, no one appeared to think that the process itself

would be in danger of overwhelming a FTSE 100 company or a listed, European organisation operating across borders with the requisite HR infrastructure.

The fundamental advantage of creating a specific job description for each boardroom appointment, it was widely agreed, was the focus it would bring to the question of what is expected from the appointment of a particular non-executive director.

The differing structures and needs of boardrooms across the EU mean that it is not possible, or desirable, to be overly prescriptive. Every publicly listed company needs to consider the nature of its own business and what it requires from its non-executive directors. However, there is widespread agreement about the need for more breadth and perspective in boardrooms – and this extends beyond gender diversity alone.

“I would always recommend a professional, structured approach to recruiting non-executive directors. As consultants, we start with an analysis of the current situation and the make-up of the team, and then we look at what’s missing in terms of core competencies and come up with appropriate solutions. However, in Germany, in more than 50% of cases, companies don’t take such a structured approach. Instead, they tend to rely on their network.”

Dr. Stefan Fischhuber, Managing Director, Kienbaum Executive Search Consultants

“We do hear from companies that headhunters often put the same lists forward. It is hard to determine how much of that is due to the ‘client spec’ – in terms of the chairman not giving a clear brief as to what they want looked at [for a specific board position].”

Chris Hodge, Director of Corporate Governance, Financial Reporting Council (UK)



Succession planning

Evaluation and appraisal of non-executive directors is an essential ongoing process that helps to refresh the capabilities of any boardroom. In reality, smaller and medium-sized companies may only have a handful of non-executive directors, who will therefore be on every committee. There is clearly a need to distinguish between well-resourced companies and smaller businesses that do not have the resources to keep changing their non-executive directors. But, there is scope for appointments from a wider pool of talent than research to date has suggested.

“The DAX [German share index] community is tightly knit and appoints those whom it already knows from other institutions. Executive Search mostly gets involved if the firm’s board is less well connected, or if there is a need for diversity candidates.”
Dr. Christine Stimpel, Partner, Heidrick & Struggles

“The management structure in all companies is a pyramid. When people get to the top, they need more than just cash to keep them motivated. Placing individuals on committees just below board level is one way of showing them how much you value them – and also getting them ready.”

Malcolm Le May, Member of Audit & Remuneration Committee, Pendragon, and Non-Executive Director

“It’s almost a prejudice that exists in boardroom recruitment – not a gender or a social prejudice that may exist in individual cases, but where prejudice is really demonstrated is [that] one repeatedly hears that you can’t ask the right questions on a board if you haven’t done the job before ... The requirements, therefore, create obstacles to diversity. It *de facto* means you don’t get female members, and the result of this approach means that there is an insufficient pool of talent.”

Roger Barker, Director of Corporate Governance and Professional Standards, Institute of Directors (UK)

Our findings also suggest that there is a widely held view among many with boardroom experience that the average age of the executives in Europe’s boardrooms should be coming down, especially in fast-moving consumer goods companies. But non-executive director remuneration remains a controversial subject; it is widely perceived as being too low to attract ambitious younger candidates, especially as a great deal more is now being demanded of board members amid heightened compliance and regulation. Looking across industry sectors, it is difficult to see how age can come down in any substantive way within existing boardroom recruitment and compensation structures in Europe. There remain only the inevitably rare instances involving appointments of successful entrepreneurs or established businessmen and women who are attracted by something other than the remuneration involved.

Lessons to be learnt from audit committee composition

Recent EY research, compiled by Tapestry Networks for EY's *InSights for European Audit Committees*, found that "diversity of culture, role and experience is the most important element of an audit committee."¹ Although the traditional financial controls and reporting duties of the audit committee are as important as ever, the paper found that the audit committee's role has expanded significantly. Potentially, this could lead to a broadening in thinking about the right person to serve as a non-executive director. Such wider thinking on the skills needed for an effective audit committee is mirrored by our research into the range of talent required to create effective boardrooms.

"The chair of an audit committee has to have financial skills, and it would be unusual for a major PLC to have one who wasn't a chartered accountant – especially as financial reporting has become much more technical in the last few years. But not all committee members need to have an accountancy qualification – in fact, you want a balance of skills better to reflect the readership of the accounts. All members are, of course, entitled to take independent advice."

Nicholas Hamilton, Senior Independent Director & Audit Committee Chair, Miton Group PLC

"You need to go back to basics and think about what an audit committee is trying to do – they are not the chief accountants or the internal or external auditors. If you have a lot of accountants, you get people second-guessing each other, instead of taking an overview on the state of play. Having people with different levels of experience and viewpoints means they ask different questions – otherwise you get 'groupthink'."

Malcolm Basing, Chairman, Newedge and Non-Executive Director

"In Germany, the members of audit committees are mostly men; a financial and audit qualification is still deemed the most important thing, and the legal requirement to have a financial expert is determining the current recruiting process. This and liability risks also contribute to a shortage of talent."

Daniela Mattheus, Leader, Corporate Governance Board Services, EY Germany, Switzerland and Austria

EU regulation may soon counter any thinking in Europe about opening up the audit committee to qualifications and experience outside finance. A directive currently under consideration² recommends that there be two people with an accounting qualification on the audit committee of every publicly listed company. The final text of the proposal has still to be adopted; most of the provisions will apply two years after the date the regulation comes into force.

In the UK, for example, the Financial Reporting Council (FRC) has concerns about the effect of such a mandatory requirement, particularly for smaller PLCs with very few non-executive directors. "We are in favor of not being overly specific about qualifications, as needs change over time," Hodge comments.

Selection criteria for individual board members

Our research suggests that the true reason for lack of diversity on European boards is that the appointments process remains locked into a small pool of talent and constrained by the fundamental requirements for boardroom positions. These requirements have not been reconsidered via open debate or consultation, and have therefore not changed for decades.

Experienced board members and corporate governance practitioners interviewed for this report agreed that most companies look to the same group of potential applicants for their non-executive directors. This inevitably limits their options for achieving any possible diversification of the board.

"Accounting skills are not necessary to be a non-executive director, although basic numeracy is an advantage – especially in financial services businesses. Boards need a range of age, gender, background and skills, together with people with inquiring minds. We also need people who can use social media in business. You should be looking for someone who can support as well as challenge the business."

Nicholas Hamilton, Senior Independent Director & Audit Committee Chair, Miton Group PLC

Five ideas with potential to transform boardroom recruitment

1. Review the requirement that candidates must have previous high-level boardroom experience.
2. Widen the search to include those with analytical skills, independence of thinking and a capacity to support as well as challenge.
3. Realign the composition of the boardroom to the needs of the business by looking at numbers of non-executive directors, duration of service and sector-specific needs.
4. Consider advertising for boardroom posts.
5. Provide training for would-be non-executive directors within your own company by placing them on committees just below board level.

1. "Greater business challenges call for stronger audit committees," *InSights for European Audit Committees*, issue 18: August 2013, EY, 2013.

2. *Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities*, European Commission, 30 November 2011, Article 31.

“As with the rest of Europe, French boards tend to be composed of people from a similar background. I believe we need a new perspective and would like to see boards introduce more independent directors from a wider range of backgrounds, to complement the knowledge of established French members. In 2013, EY’s research reported that 55% of all new board members in France were women, which is a critical step towards reaching a female quota of 40% by 2017. We also noted a distinct increase in diversity across other areas, including the appointment of board members from outside France.”

Bruno Perrin, Assurance Partner, EY France

“Boards need to be open-minded to individuals with a strong analytical background. You don’t just want a board full of accountants.”

Kate Grussing, Managing Director, Sapphire Partners

“We have to make bold choices and get out of our comfort zone (in board selection). We need to look at representing both the customer base and the employer base in our boardrooms. A board should project the strategy of the future and make sure it represents where the company is headed in the medium to long term, not the short term. If there is no pipeline, we need to grow our own people - take a chance, take a risk and mitigate it, like any other. It’s a business imperative.”

Ruby Sharma, Program Sponsor, US Audit Committee Center for Excellence, EY

Financial services stands out as a sector because of the complexity of its boardroom recruitment requirements, particularly in the wake of the 2008 financial crisis. But, having to get the approval of the regulator (as is the case in the UK, for example³) - combined with long delays in appointments being approved and an inevitable amount of publicity once they are approved - is increasingly a deterrent for those who are, in any sense, outsiders to the inner circle. Speaking confidentially, one interviewee described financial services as “a special sector - one where the debate between independence and experience rages.”

At the same time, there appears to have been an important change in terms of the recognition of the value of having more women on Europe’s company boards. It is clear that this seems to be a particularly good - if not always welcome - idea in a male-dominated financial services sector.

“In my experience, women do improve the quality of debate in the boardroom. To be fair, irrespective of gender, a healthy and constructive relationship between executive and non-executive directors, based on mutual respect, is vital.”

Malcolm Le May, Member of Audit & Remuneration Committee, Pendragon, and Non-Executive Director

“There are enough female candidates, perhaps more than we thought. Women are more willing to share their professional life with other duties, normally more balanced and, most importantly, they immediately change the ambience of a board. One is good, two or three is better - the tone of the board improves and the conversation gets less emotional.”

Patrick Zurstrassen, Chairman, European Confederation of Directors’ Associations

Cross-border discussions continue on the need for quotas to address gender disparity on boards. Norway was the first country to adopt gender quotas. In 2003, its Parliament passed a law requiring publicly listed companies to fill at least 40% of seats on their boards with women by 2008. Other nations swiftly followed suit in setting quotas, including Spain, Iceland and France. The EC has now adopted a proposal for an EU law setting the objective for women to represent 40% of non-executive board members in large, publicly listed companies by 2020.

Some observers, however, are convinced that women still face a battle to achieve recognition. “Let’s face it: letting women into the boardroom also means a shift of power, which some men may not want to see happen,” says Turid Solvang, Managing Director of the Norwegian Institute of Directors. She adds that, in her opinion, the argument that only those with previous boardroom experience are “qualified” for board roles may be used as a means of retaining power.

“The idea that there is only one woman available for a job six men could do is rubbish. A 40% quota could easily be filled. It’s the pipeline that’s the issue.”

Off-the-record comment from a male observer of many boards

3. Under the Financial Services and Markets Act 2000, a nominee for a non-executive director role (among others) at a financial services company must first be approved as “fit and proper” by either the Financial Conduct Authority or the Prudential Regulation Authority.



Induction and mentoring for a wider pool of talent

“The reason boards should consider including communications directors is that these are people who should still be able to have an external view and be a conduit between what the world is saying and what is really happening. If they are good, they have already honed all the right skills to ease into the boardroom.”

Geraldine Davies, Chairman, Ellwood Atfield

* Onboarding - bespoke process that enables new board members to acquire the necessary knowledge, skills and behavior to become effective representatives.

The attraction of being in the boardroom - the pinnacle of strategic business thinking - cannot be underestimated, across Europe and beyond. The challenge lies in how best to find and place the right candidates in the positions where they can be most effective. Our research found considerable support for the idea of active, hands-on training and onboarding* in order to create a wider and more effective pool of non-executive directors.

Where women are concerned, there have been attempts to provide visibility to those who might otherwise be overlooked. In the last few years, various databases have been created in an attempt to make it clear that there are “board-ready” women available to step into boardroom roles, and there are many training schemes for non-executive directors as well.

One of these databases is run by the *Financial Times* Non-Executive Directors’ Club, which recently went into partnership with the European Business Schools and Women on Board Initiative to create data identifying high-achieving women in business. This Global Board-Ready Women database allows companies to search more than 8,000 highly qualified women who are ready to take up a board-level position. The Association of Executive Search Consultants also gives enhanced access to people on this database to its headhunting community.

But is there any scope for Europe’s publicly listed companies to provide their own training for the boardroom? This would be an initiative beyond the induction process for new non-executive directors in any given boardroom. It would also be separate from existing recognition in many boardrooms of the value of having CEOs of other PLCs on your own board. It might involve businesses actively working to train individuals for boardroom skills, both within their own company and within industry at large. Most of our interviewees were of the opinion that this is an idea that should be explored further.

“While databases prove there is indeed a wide supply of board-ready women, only hands-on training can give the necessary experience. So why can’t we have mentoring in the boardroom? There should be no reason why we can’t implement the concept of a ‘boardroom trainee.’ It is time to consider new ways of thinking.”

**Turid Solvang, Managing Director,
Norwegian Institute of Directors**



“As a non-executive director, your role is not to train other non-executive directors to do the job. So, the question with training is not whether or not it’s appropriate, but how are the skills to be acquired? Having said this, a mentoring process within the boardroom is essential.”

Nicholas Hamilton, Senior Independent Director & Audit Committee Chair, Miton Group PLC

“I don’t see any logical reason why business can’t launch training for the boardroom. Existing induction schemes tend to be company specific, and, as such, don’t provide guidance on the more general role of a non-executive director.”

Malcolm Le May, Member of Audit & Remuneration Committee, Pendragon, and Non-Executive Director

“Just as businesses are starting to mentor women within the company to bring them up to the boardroom, you could look at mentoring in the boardroom as part of a development program for the business. We repeatedly hear that ‘you can’t ask the right questions on a board if you have never done the job.’ But being a non-executive director is very different from being an executive. Individuals from all these backgrounds could potentially do it: public sector, consultancy, journalism, academia, professional sector and law.”

Roger Barker, Director of Corporate Governance and Professional Standards, Institute of Directors (UK)

The attraction of focusing on training to widen the pool of talent in Europe’s boardrooms is mirrored elsewhere. In the UK, Malcolm Le May, an experienced Non-Executive Director, suggests that there has been a trend among quasi-governmental bodies, as well as boards of pension funds, to appoint outsiders for broader thinking. “Observers are also possible in the boardroom, and their value is often underestimated,” he adds.

Conclusion

- critical success factors

Based on the insights gained from conversations with our clients and board leaders across Europe, we have identified five practical steps to improve boardroom recruitment:

1. Structure

You can start by realigning the composition of the board with the evolving needs of the business, looking at issues such as numbers and profile of non-executive directors, duration of service and sector-specific needs. You might also consider rotating non-executive directors regularly and appointing individuals with a wider range of skills. This can help open up the board's approach to managing changes effectively and sharpen its awareness of future developments.

2. Process

You could investigate ways of using headhunters more effectively, such as rotating recruitment firms and separating evaluation from search. You could also consider hiring headhunters who represent the candidate, rather than the client. Instead, you could advertise for boardroom posts, or use the growing number of databases to identify candidates who could bring new perspectives to the board.

3. Criteria

In order to create a larger pool of potential candidates, you should abandon the requirement that candidates "must have experience of a PLC board." Instead, you should widen the search to include those with analytical skills, independence of thinking and a capacity to support as well as challenge.

4. Succession

Make a succession plan and keep it transparent. Then, in order to create a high-quality pipeline of talent, provide training for would-be non-executive directors within your own company by placing them on committees just below board level. You can bring them in occasionally for presentations to the board, or appoint them as observers on a rotational basis.

5. Support

The ideas above are all based on the principle of individual companies changing the way they think about boardroom recruitment. But, might it be possible for large cross-border businesses to collaborate in the creation of a "board secretariat" to provide support for all non-executive directors, in terms of resources as well as opportunities? Such an organization could potentially provide training for those who aspire to be non-executive directors, with their employers recommending them for participation in suitable courses. This is a radical idea, and one that would undoubtedly prove challenging to implement - but it may be one whose time has come.

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