On the 2024 nomination committee agenda

KPMG Board Leadership Centre

Companies face unprecedented disruption and uncertainty – a turbulent economic and geopolitical environment, wars in Ukraine and the Middle East, ESG commitments, talent management, and advances in AI and its regulation will continue to test the skills and experience of board members. Has the board reviewed board composition in line with new strategic imperatives, reviewed succession planning, and shifted the dial in relation to equality and opportunity for talented people to succeed? Drawing on insights from our global Board Leadership Centre community, we highlight six considerations for nomination committees' 2024 agendas. Though we operate in diverse regulatory systems, there is a strong commonality of themes faced by boards around the world.

Skillsets to expand and enhance ESG oversight

Environmental, social and governance (ESG) continues to be a critical consideration for businesses, investors and shareholders across all sectors. Whilst climate change remains front and centre, some of the challenges within the 'S' of ESG have rapidly risen up the agenda.

Oversight of ESG related risks, opportunities and reporting – including regulatory requirements, new metrics and stakeholder pressure to 'get it right' – starts with an ESG competent board. Our KPMG 2023 CEO Outlook UK survey found that a lack of skills was the biggest problem holding back ESG programs. Boards need to have ESG risk, and its impact on long-term value creation, top of mind. This will include an understanding of which issues are of greatest risk or strategic significance to the company, how they are embedded into the company's core business activities, and whether there is strong executive leadership behind the company's response to ESG matters. Promisingly the 2023 Spencer Stuart Board Index found that 37 percent of the top 150 FTSE companies have a committee to oversee environmental and social topics – an increase of nine from 2022.

For example, oversight over climate risk will likely sit across several board committees. The audit committee may be best suited to issues around systems data and reporting, whereas the remuneration committee will be concerned with the reward mechanisms that drive the right behaviours. For the nomination committee, the focus is on ensuring the board and senior executive team have the appropriate skillsets and development mechanisms in place. Overlap is to be expected, but coordination, information sharing and communication among committees is key. Wellbeing, and inclusion, diversity and equity (IDE) issues are firmly mainstream and remain high on the nomination committee's agenda. IDE is a key pillar within any ESG framework.

Our CEO survey found 69 percent of CEOs agreed that progress on diversity and inclusion has moved too slowly. Stakeholders – from shareholders to employees – are looking at a company's record on inclusion, diversity and social mobility when making decisions. And they're looking beyond what's needed to comply with legislative changes – they want to invest in, or work with, businesses that demonstrate greater authenticity in their actions and performance.

Oversight of these risks and opportunities is a significant challenge, involving the full board and potentially multiple board committees. How is the nomination committee ensuring that the board and senior executive team have the appropriate skills? Is this addressed head-on as part of the annual board evaluation exercise? Do the succession plans explicitly address ESG competency?

Enriching board decision-making through visible and invisible diversity – and its intersections

Core to the nomination committee role is ensuring that the board has the right combination of skills, backgrounds, experiences, and perspectives to probe and challenge management's strategic assumptions and to support management in navigating the company through an increasingly volatile and fast-paced global environment.

Progress has been made in terms of women on boards. However, progress is required in other areas to take a more holistic and intersectional approach to equality, including women in executive positions, sexual orientation, disability and geographical heritage, as well as 'invisible diversity' traits such as socio-economic background and cognitive diversity. Diversity of international experience is also important for businesses operating across many different markets.

Consider the strengths that 'invisible' diversity traits such as socio-economic background and cognitive diversity of board members could bring into board discussions. Our survey 'Uncovering social mobility in the boardroom' found over 70 percent of respondents came from a professional background versus just 15 percent who come from working class backgrounds – suggesting a lack of socio-economic diversity in the boardroom, and 69 percent of respondents stated that nomination committees were not addressing diversity of socio-economic background during board appointment and succession activities. A more recent study by Progress Together found half of all senior roles in the financial services sector are held by white people from a higher socio-economic background. The intersectional lens on the data highlighted the 'double-disadvantage' faced by women from working class backgrounds, and how the opportunity to reach a senior role for working class women from ethnic minority backgrounds becomes harder still.

Cognitive diversity is also an under-studied and complex area. Diverse hires may not automatically result in increased performance – for these efforts to 'bear fruit', boards should consider if they have created a psychologically safe inclusive culture that allows diversity of thought to thrive. Cognitive diversity helps to reduce groupthink and challenge assumptions – creating robust strategic thinking.

Does the nomination committee use personality testing or cognitive profiling to assess whether the board has a mix of personalities and decision-making styles that best contribute to effective oversight and decision-making?

Expect continued legislative and regulatory action on board composition and diversity. Recent consultation papers from the FCA and PRA propose to boost disclosures on diversity and inclusion with the intention of creating healthier work cultures, unlocking talent and reducing groupthink.

Also, be cognisant of the increased level of investor engagement. Some investors and proxy voting agencies are monitoring whether companies are meeting the 'Listing Rule' requirements on diversity targets and are equally interested in whether the drive for diversity extends to the wider workforce – focusing on gender pay gap data and voluntary reporting on ethnicity pay gaps.

Lastly, think about the breadth of the talent pool from which new board members are sought. Has sufficient attention has been given to recruiting directors with backgrounds in the third sector, academia and government, as well as entrepreneurs and those from family businesses? Challenge recruitment firms to provide a more diverse list of candidates and be specific about the skills and attributes required. If recruitment criteria are overly prescriptive, it might discourage diverse candidates and limit cognitive diversity.

Board skills required to support growth

The continuing priority is to ensure that talent, in the boardroom and in the pipeline, is aligned to strategy – even where that strategy has changed significantly in reaction to the events of the last two years.

Demand for experience in business transformation, growth, technology and restructuring is likely to continue. Leadership styles have pivoted towards empathetic leadership, a broader understanding of issues affecting the workforce, and wellbeing issues remain high on the agenda.

What steps is the nomination committee taking to ensure the board, leadership and senior management team are fit for purpose and well-placed to support sustainable growth? What development plans are in place to support both senior managers and those in the pipeline?

Advisory boards might be considered as a mechanism to fill any skills gaps and support the board in the execution of its duties. However, clarity over their role, authority and place within the organisation's governance framework will be key to success.

Equally, the use of third party advisers to support the board in areas where specific expertise is needed will likely continue, but regulators and investors are increasingly seeking greater transparency around who such advisers are and any affiliations, financial interests or ties that might bias their judgement and therefore impact their advice.

Digitalisation, robotics and AI are increasingly important components of many corporate strategies. Individuals with deep technological expertise can be hired at an executive level but board members still need to be able to 'ask the right questions' and just as important, 'understand the answers', to be capable of contributing across the range of issues the board faces. Have the risks around inexperience been historically overstated? If not, have they now been surpassed by the potentially higher risk associated with a board lacking in technology literacy?

Consider looking beyond the 'usual suspects' to find people with different experiences and backgrounds – including those who have not served on a listed company board before. With appropriate induction, mentoring and coaching, new directors should be able to adapt reasonably quickly.

Finally, courage, integrity and the emotional intelligence to provide a balance of perspectives should not be underestimated as key requirements to help the CEO and organisation recover and support growth once again.

Succession planning

The UK Corporate Governance Code puts diversity at the heart of good governance, requiring nomination committees to link their policies on diversity and inclusion firmly to their business strategy and to promote diversity in terms of new appointments and in their succession planning. However, many companies are providing very little information on how they have sought the right mix of skills and perspectives to drive their long-term success.

The FRC's 2022 Review of UK Corporate Governance Reporting stated that extended chair tenure (beyond nine years) was still a potential risk, and while some companies provided a reason for not complying with the code on this area, nomination committees should be mindful that long-term tenure can lead to higher risk of complacency and groupthink.

Similarly, the FRC have reported that many AGM notices relating to the re-election of directors simply cross-refer to the biographies included within the annual report, and said nothing about how they contribute to the long-term success of the business. The more informative notices had detailed biographies and briefly explained why each director should be re-elected. The best clearly outlined the reasons for an individual's re-election, specifically linking their contributions to company strategy and risks.

If recent times have taught us anything, it is that having robust succession plans for times of stress as well as more benign times is critical.

Successors may be identified from 'rising stars' who have dealt with crises, those that sit on multiple boards who can share insights from other organisations or have expertise in tech innovation. The trend for boards to identify talented individuals to become 'board apprentices' to observe the boardroom and provide independent feedback, as well as gain valuable training to reach board level is increasing.

Potential candidates should be assessed to provide reassurance that they have demonstrated ethical behaviours – the frequency of stories related to bullying, sexual harassment and personal relationships are increasing. As well as being aware of the organisation's code of conduct and policy on ethical behaviours, boards should also review their due diligence requirements when recruiting new members.

Nomination committees should, as far as possible, seek to preserve stability at the top of the organisation by avoiding appointing the chair and CEO in quick succession. Similarly, nomination committees should, as far as possible, manage the retirement of board members so as to avoid losing too much 'corporate memory' in one go.

Planning for increasingly active investors

In an environment where company directors face annual election, institutional investors are increasingly using targeted voting practices to register their displeasure at the board, voting against the re-election of directors from the remuneration committee chair who displays an unwillingness to change executive pay arrangements, to the audit committee chair who presides over a period of accounting irregularities.

ESG has now become a factor too, with major investment houses going on record to say they would take voting action against directors at companies that were laggards based on their ESG scores and/or those that cannot articulate how they plan to improve their ESG metrics.

Also, institutional investors (and proxy voting agencies) have shown a degree of disquiet around 'over-boarding' – a practice where individual directors are deemed to hold 'too many' roles. Proposed changes to the UK Corporate Governance Code – asking that all significant director appointments be listed in the annual report alongside a description of how each director has sufficient time to undertake their role effectively in the light of commitments to other organisations – are designed to allay this risk. However, nomination committees should carefully consider whether individuals will be able to discharge their duties diligently and effectively when appointing new board members or when existing board members seek additional board mandates.

The nomination committee chair in particular should be wary of non-adherence to best practice, and can expect to be voted against, if: the roles of the chief executive and chair have not been split; a senior independent director has not been appointed; the board has not conducted an externally facilitated evaluation of its effectiveness within the past three years; or an individual who has a significant conflict of interest, or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests is nominated (or re-nominated) to the board.

The voice of the workforce and wider stakeholder perspectives

Stakeholder perspectives are relevant for all board appointments and should be a considered as part of succession planning and the selection process. Given the significant influence that a company's key stakeholders have on an organisation's success, the board's knowledge and understanding of the interests of stakeholders is vital.

Is the nomination committee considering appointing a non-executive responsible for getting the voice of the workforce into the boardroom? If not, should this be revisited? Is there a formal process? Are specific characteristics and skillsets sought? Has consideration been given to tenure and rotation issues? Is more than one designated NED necessary if the company has a large geographical footprint?

For many, workforce directors still sit uncomfortably with the traditional corporate governance framework and are rare within publicly listed organisations. Nevertheless, they can provide tangible benefits to companies – particularly at a time when talent development strategies are being adjusted to meet the challenge of finding, developing, and retaining talent amid a labour-constrained market. Does the decision to not have a workforce director need revisiting? What can be learned from those who have appointed workforce directors?

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

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February, 2024 1226485188BLC