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On the 2022 nomination committee agenda

KPMG Board Leadership Center

Business recovery and growth, the long-term effects of the pandemic and ESG commitments are likely to continue to test the skills and experience of board members. Has the board taken the opportunity to review its skill map and potentially reshape board composition in line with new strategic imperatives, review its succession planning and shift the dial in relation to fairness, equality and opportunity for talented people to succeed? Drawing on insights from our work, interactions with board members and business leaders as well as the annual SWIPRA Corporate Governance Survey and experience from SWIPRA Services, we highlight eight issues for nomination committees to keep in mind as they consider and carry out their 2022 agendas.

Skillsets to expand and enhance ESG oversight

Environmental, Social and Governance (ESG) has become a critical consideration for businesses, investors and shareholders across all sectors. Climate change is front and center and social factors have gained greater attention over the past year as COVID-19 forced working and living practices to change, highlighting the social issues that were already there. Indeed, according to the SWIPRA survey evidence, social topics became one of the key engagement priorities in 2021. Importantly, the board needs to take leadership on these topics and communicate transparently on how it intends to deal with ESG. This leadership is so far oftentimes missing as only a third of the survey's institutional investors considered it sufficient.

Oversight of ESG-related risks – and equally importantly, the opportunities – starts with an ESG-competent board. Not every board member needs to have deep-dive ESG expertise, but the board, as a whole, needs to have ESG risks and opportunities and their impact on long-term value creation, on top of its agenda. They need to understand which issues are of strategic significance and carry the greatest risk or opportunity 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 environmental and social priorities.

The nomination committee has an important role in answering to this by communicating more comprehensively how ESG knowhow and skills are of strategic relevance and thus considered in the board refreshment process. This usually starts with a process to identify gaps between skills and experiences. In the 2021 SWIPRA Survey, only 22% of the institutional shareholders stated that they understand how ESG considerations impact the board refreshment process and for more than half of the investors it was unclear what skills companies need for the future.

ESG board organization – dealing with overlaps

Oversight of ESG risks and opportunities is a significant challenge, involving the full board and often also multiple board committees. For example, elements of climate, social and DEI (Diversity, Equity and Inclusion) oversight often reside within the audit and risk committees, the remuneration and/or the nomination committee – while other committees, such as an ESG, sustainability or strategy committee, may share some of these responsibilities as well. Overlap is to be expected, and careful evaluation is required as to which committees are really needed and what tasks should be left with the full board. Effective information sharing, communication and coordination among committees needs to be ensured and committee charters and organizational rules have to be clear in allocating responsibilities. These committees must also have the expertise to oversee such additional issues delegated to them.

The nomination committee clearly is playing a critical role in ensuring that the board and its committees have the right skills and governance structures to be fit for purpose. This can be addressed head-on as part of the annual board evaluation process, as it is suggested by the Swiss Code of Best Practice in Corporate Governance. Such evaluations generally help to identify gaps in skills and experiences.

Enriching board decision-making through visible and invisible diversity

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.

Besides skills and experiences, a board's diversity among socio-economic traits has become a key agenda item of many institutional investors while diversity in terms of international experience is key for businesses operating across many different markets.

With respect to the latter, boards of listed companies in Switzerland rank amongst the most diverse ones, appreciating the highly international scope many Swiss companies have. Amongst the 20 largest listed companies (SMI®), more than half of the board members are non-Swiss, amongst the 100 largest companies the fraction is 36% (SWIPRA AGM Review 2021).

Research has further revealed that individual differences (Personal/Neuro/Personality) are seen by directors as the most significant and important source of diversity in the boardroom, compared to demographic differences including gender, ethnicity and nationality. But do nomination committees 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?

Additionally, the breadth of the talent pool from which new board members are sought should also be considered. Has sufficient attention 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.

Ultimately, it also raises the question of whether the nomination committee is working with the board to set appropriate diversity goals at all levels, including leadership and senior management, business unit heads, middle ranks, and internships. As with any other KPIs, diversity metrics should be a matter of business performance, not a nice to have.

Move the dial on gender

The debate on gender has been a long one in Switzerland and has not stopped with the coming into force of the related comply-or-explain provisions in the revised Swiss company law. The revision provides companies with a transition period until 2026 to achieve a 30% minimum representation of each gender on the board or explain their failure to do so.

Swiss boards' gender diversity continues to lag behind its key European peers, not least because many of these countries have already implemented legal minimum requirements with respect to gender diversity, setting hurdles at 30% or 40%. Amongst the largest 100 listed Swiss companies, only 34 so far have a representation of each gender at or over 30%.

Nomination committees will face increasing scrutiny from shareholders and proxy advisors, many of whom indicated that they will no longer approve of gender representation levels below 30% in the largest companies (SLI®) and look for tangible strategies to achieve this level in smaller companies. For nomination committee members, arguing against this threshold by referring to the legally provided transition period is, therefore, not a promising approach.

Tone from the top – its all about managing reputation

A key question nomination committee members need to address is whether the committee is working sufficiently close with the board and CEO to demonstrate leadership from the top with respect to talent and skills management. Employees are often described as key strategic asset of a company and the market should, therefore, see a commitment to building the company's pipeline of diverse employees and board members in both actions and conduct. Is the nomination committee seeing for itself what things are really like on the ground? Are they networking with people from various backgrounds to understand the challenges and support any allyship, mentoring and development programmes?

In addition, members of the nomination committee need to be sufficiently skeptical when confronted by management with the explanation that lack of progress is due to a "lack of qualified candidates". The phrase is often misused and an excuse for insufficient recruitment efforts. Understand the extent to which recruitment functions are connected to diverse communities and their ability to tap into a wide pool of diverse candidates; and create challenging targets to your recruiters and or headhunters.

Tell the company's diversity and inclusion story in detail. An honest picture of the company's goals and progress towards achieving them is important in terms of credibility and confidence, even if it means to convey failure to achieve the desired diversity target.

The way boards communicate, engage and report on diversity will be critical going forward. Businesses that create frameworks that are transparent on the steps being taken to understand the issue within an organization, deliver a plan and regularly report on the outcome will signal to employees and customers, their commitment to change and improve.

Board skills required to support growth

Whilst the pandemic may have highlighted those skill-sets that come to the fore in a crisis, 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 18 months.

Demand for experience in business transformation, recovery, technology and restructuring is likely to continue. Leadership styles have pivoted towards empathetic leadership, and wellbeing issues have risen up the agenda. What are the action points that the nomination committee is taking to ensure the board, leadership and senior management team are fit for purpose and well placed to support recovery and 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 skill gaps and support the board in the execution of its duties. However, clarity over their role, authority and place within the organization's governance framework will be key to success.

Equally, the use of third-party advisors 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 advisors are and any affiliations, financial interests or ties that might bias their judgement and therefore impact their advice.

Be cognizant of this increased level of investor engagement on this issue – perhaps highlighting investor frustration over the relatively slow pace of change in boardrooms and pointing to the central challenge with board composition: a changing business and risk landscape. Addressing competitive threats and business model disruption, technological innovation and digital changes, climate and ESG risks, cyber risk and global volatility requires a proactive approach to board-building and board diversity – of skills, experience, thinking, gender, and race/ethnicity, etc. – is central to that.

Digitalization, robotics and AI are an 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', in order to be capable of contributing across the range of issues the board faces – but have the risks around inexperience been historically overstated? And even if not, have they now been surpassed by the potentially higher risks 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. Different leadership styles may unlock organizational success, and with appropriate induction, mentoring and coaching, new directors should be able to adapt reasonably quickly.

Courage and the emotional intelligence to provide a balance of perspectives should not be underestimated as key requirements to help the CEO and organization recover and support growth once again.

Succession planning

Many institutional investors are putting diversity at the heart of good governance, requiring nomination committees to link their policies on diversity firmly to their business strategy and to promote diversity in terms of new appointments and in their succession planning. However, many companies continue to provide very little information on how they have sought the right mix of skills and perspectives to drive their long-term success. According to the SWIPRA survey, it is only (very) clear to 24% of the investors which key skills and experiences are currently represented on the Board.

Moreover, details on succession planning also remain scarce, with very few companies articulating the deeper considerations around succession planning or the progression plans for those looking to move to board level. Only 4% of the investors have an understanding of the skill and experiences the board is expected to have going forward.

Similarly, many AGM notices relating to the (re-)elections of directors simply cross-refer to the biographies included within the annual report and say nothing about how these directors 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 proposal to be elected to the board, 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 the impacts of the crisis and those that sit on multiple boards who can share insights from other organizations. 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.

The continued use of online recruitment tools and practices such as video interviewing could help to widen the talent pool as physical meetings become less of a logistical barrier.

On a related note, nomination committees should, as far as possible, seek to preserve stability at the top of the organization 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 the unique Swiss setting with individual annual elections to the board, the compensation committee and the board's chair, institutional investors are increasingly using targeted voting practices to register their displeasure with individual functions within the board or the board overall. This could, for example, entail voting against the re-election of directors to the remuneration committee if this committee seemingly displays an unwillingness to change executive pay arrangements, or against the audit committee members who oversaw a period of accounting irregularities. During the Swiss AGM season 2021, the median fraction of free-float against votes (i.e., excluding strategic investors) was 2.8% for regular board members, but 8.2% for board chairs, 8.9% for nomination committee chairs and 9.7% for compensation committee members (SWIPRA AGM Review 2021).

ESG has now also become a factor that major investment houses and proxy advisors have revised in their proxy voting policies to take a much more structured approach towards companies in assessing how their board is taking ownership of the ESG discussion within the company. Absent such information, voting action is likely to focus on the board's chair or sustainability committee members.

In 2021, following the first year of the pandemic and realizing that such an event may concern most companies and their boards around the globe at the same time, institutional investors have become increasingly worried about the number of external mandates a director may hold. The trend seems to be towards a recommendation of four mandates, with the non-executive board chair roles counting as two and executive positions as three mandates. Committee appointments and geographical spread of mandates is also increasingly a point of scrutiny for investors.

This document was prepared in collaboration with SWIPRA Services.

SWIPRA Services provides corporate governance and corporate social responsibility services for listed companies and their boards of directors. We provide our clients with hands-on advice that takes into consideration relevant stakeholder opinions with the aim of increasing the value of the company in the long term, based on principles of value-based management and empirically relevant criteria. SWIPRA Services is working with a high-profile think tank to further develop corporate governance and CSR in Switzerland. The SWIPRA Corporate Governance Survey has been conducted annually since 2013: www.swipra.ch/survey

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About the KPMG Board Leadership Center

The KPMG Board Leadership Center offers support and guidance to board members. We equip you with the tools and insights you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business. In addition, we help you to connect with peers and exchange experiences. If you are a board member, this is your platform.

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