A time for boards to act

According to a new survey, directors see good operations and effective execution of key board activities linking with stronger self-reported performance, suggesting that value can flow from improving the way boards work.

Jean-François Martin

One of the more tantalizing—and elusive—questions in corporate governance has long been what effect the board of directors has on financial performance. In a McKinsey Global Survey of more than 1,100 directors, we attempted to test the link between the quality of board operations and boards' effectiveness at their core activities with self-reported financial performance relative to peers. Indeed, the results suggest that boards with better dynamics and processes, as well as those that execute core activities more effectively, report stronger financial performance at the companies they serve.

The findings come at a time when board responsibilities are growing beyond traditional oversight to involvement in critical issues, such as strategy, digitization, and risk.[1] In this survey, the fifth of its kind, we asked directors about three dimensions of board operations: dynamics within the board, dynamics between the board and executives, and board processes.[2] While the results indicate that few boards maintain good operations across all three dimensions and that processes are a particular pain point, they also suggest that good dynamics and processes pay off.

Overall, the survey finds that the habits and practices boards engage in have changed little since our previous survey in 2015. Boards continue to focus most on strategy, an area in which many directors still want to invest more of their time. Yet fewer respondents now say their boards have a good understanding of their companies' overall strategy. And when asked about potential business disruptions, such as digitization and cybersecurity, surprisingly few directors say these topics have found their way onto the board agenda.

Boards have good dynamics but struggle with processes

Above all, directors' responses signal no improvement in how well their boards operate compared with two years ago. When asked about board operations along three dimensions—dynamics within the board, dynamics between the board and executives, and board processes—directors say they struggle most with establishing effective processes (Exhibit 1). Less than one-quarter say new directors receive sufficient induction training to be effective in their roles. In addition, only a small share (20 percent) say ongoing opportunities are available for board members' development.

Once directors are on the board, they are seldom involved in feedback and evaluation. About 25 percent of them say that their boards regularly engage in formal evaluations or that after each board meeting, the chairs invite directors to give feedback on the meeting's effectiveness. Across ownership types, only respondents on public-company boards are more likely than average to report sufficient training and formal evaluations. In some cases, respondents even report dwindling attention to certain topics. Directors are significantly less likely this year to say that board chairs run meetings effectively and that there is an explicit agreement between the board and management team on their respective roles.

Better operations and greater effectiveness beget better relative performance

The importance of a board's effectiveness is widely discussed, but its impact on financial performance is hard to measure. We sought to understand this link better by looking at how boards operate (their dynamics and processes) as well as what they do (their effectiveness at core board activities) and comparing each measure with the financial performance of respondents' companies relative to peers.[3] According to the self-reported results, better boardroom dynamics and processes and greater effectiveness of activities seem to pay off.

At boards with top-quartile dynamics and processes, 59 percent of directors report financial outperformance relative to their industry peers, compared

Exhibit 1

Directors say their boards struggle most with establishing effective processes.

Respondents saying statement is true of their board,[1] %

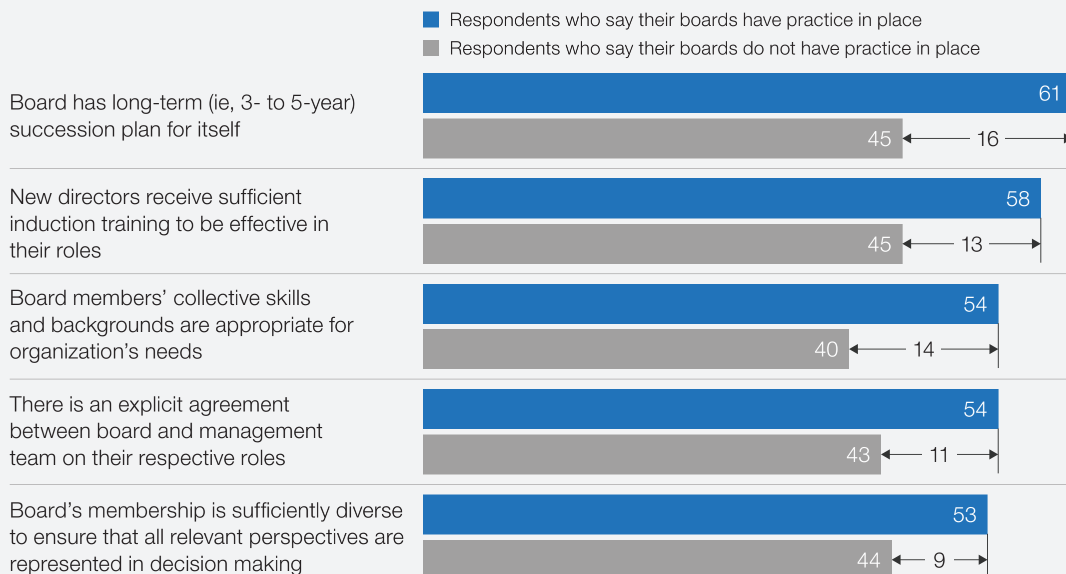
Statement	%	Percentage-point change from 2015
Dynamics within board		
There is a culture of trust and respect in boardroom	73	▲ +1
Board members' collective skills and backgrounds are appropriate for organization's needs[2]	57	N/A
Board's membership is sufficiently diverse to ensure that relevant perspectives are represented in decision making[2]	43	N/A
Board spends enough time on team building	33	▼ –6
After each meeting, chair invites directors to give feedback on meeting's effectiveness	26	▲ +3
Board–executive dynamics		
Board and management-team members constructively challenge each other in meetings	56	▼ –4
Board members seek out relevant information beyond what management provides, to deepen their knowledge of organization and/or industry	51	▼ –2
There is an explicit agreement between board and management team on their respective roles	43	▼ –7
Every board meeting's agenda includes a discussion among nonexecutive directors[2]	19	N/A
Board processes		
Chair runs meetings efficiently and effectively	54	▼ –8
Board regularly engages in formal evaluations (ie, board-team and/or individual self-evaluations)	25	▲ +4
New directors receive sufficient induction training to be effective in their roles	23	▼ –4
Ongoing opportunities are available for board members' development and training	20	▼ –2
Board has long-term (ie, 3- to 5-year) succession plan for itself[3]	18	▶ 0

[1] In 2017, n = 928; in 2015, n = 966. Excludes respondents from not-for-profit organizations.
[2] Not offered as an answer choice in 2015.
[3] In 2015, topic was "The board has a clear succession plan for itself over time."

Exhibit 2

Succession planning, induction training, and appropriate skills are the operations that contribute most to outperformance.

Rate of financial outperformance,[1] % of respondents[2]



[1] Respondents who say their organizations have higher or much higher performance on average than industry peers over the past 3 years across 3 measures: profitability, organic revenue growth, and growth in market share.
[2] n = 928. Excludes respondents from not-for-profit organizations. Out of 14 statements describing board operations; respondents were asked to select which, if any, were true of their board. Respondents who did not select any of the 5 statements above are not shown.

with 43 percent who say the same at bottom-quartile boards.[4] Further, the bottom-quartile directors are almost twice as likely to report weaker relative financial performance. According to the results, the operational practices that contribute most to outperformance are a long-term succession plan for the board, sufficient induction training for new directors, and an appropriate mix of skills and backgrounds (Exhibit 2).

The results suggest an equally strong connection between directors' effectiveness at core board activities and financial performance relative to peers. Nearly 60 percent of directors at boards in the top quartile for effectiveness say their respective organizations have significantly outperformed peers.[5] In contrast, just 32 percent of those at the bottom-quartile boards say the same. The activities that most support outperformance are all strategy related: assessing the management team's understanding of the organization's and industry's drivers of value creation, setting a comprehensive framework for the organization's strategy, assessing the strategy's accounting of industry trends and uncertainties, and debating strategic alternatives within the board as well as with the CEO.[6]

Few boards address potential business disruptions

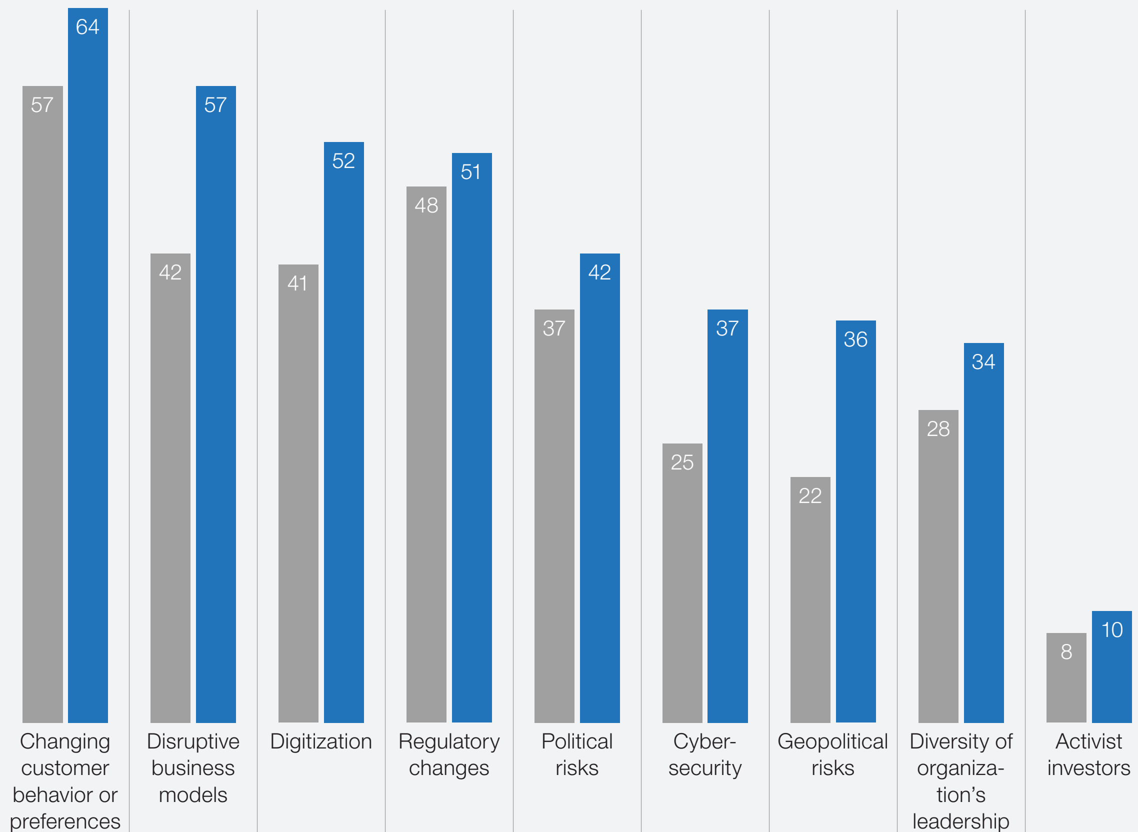
For more boards to realize the payoff from better operations and greater effectiveness, other results suggest room for where, and how, to improve.

For the first time, we asked directors about the presence of nine potential business disruptions on their boards' current agendas and their agendas from two years ago. Of the nine disruptions, the most common agenda item—both now and two years ago—is changing customer behavior or preferences (Exhibit 3). Other disruptions appear much less often: approximately half of directors say digitization is currently on their agendas, and less than 40 percent say the same for cybersecurity and geopolitical risks. But boards appear to be catching up. Between their earlier and current agendas, directors report greater consideration of all nine issues; the biggest increases in board engagement are with disruptive business models, geopolitics, cybersecurity, and digitization.

Exhibit 3

Of nine potential business disruptions, changing customer behavior is most often on boards' agendas.

Topics on boards' current and previous agendas,
% of respondents[1]

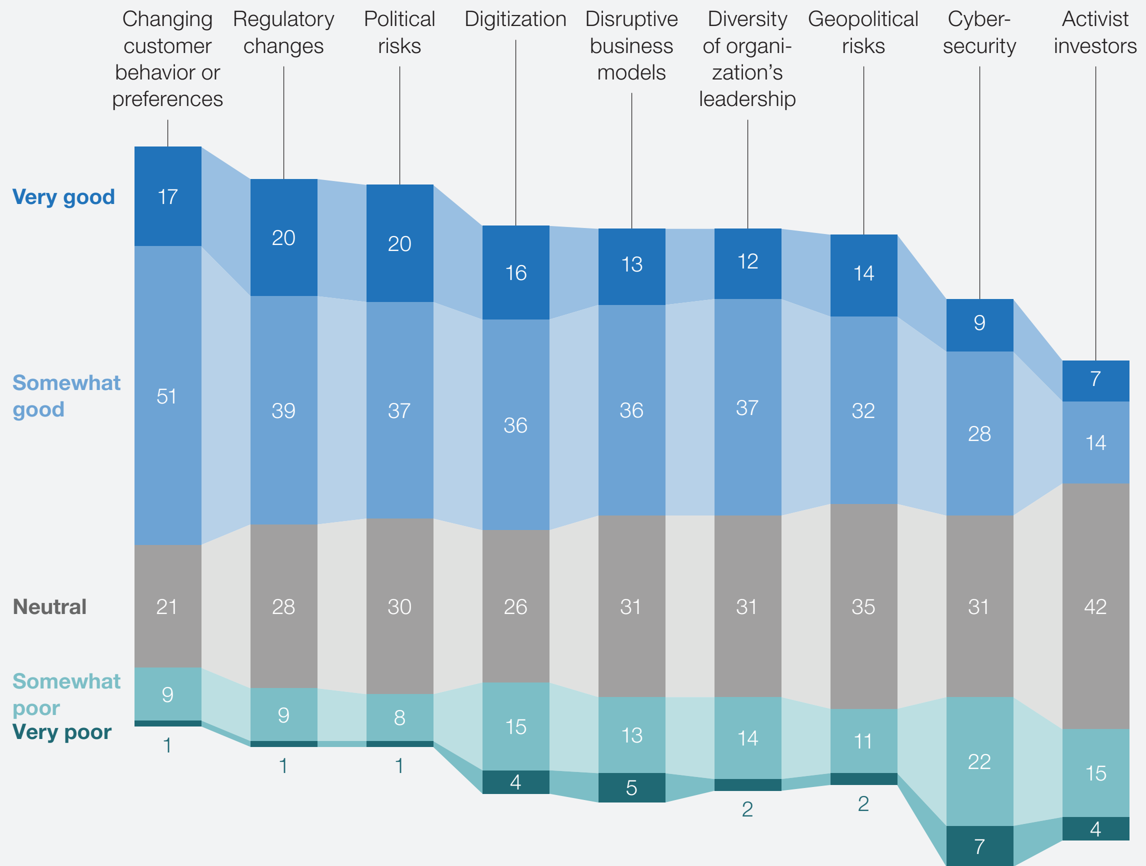


[1] Respondents who answered "other," "don't know," or "none of the above" are not shown; n = 928. Excludes respondents from not-for-profit organizations.

Exhibit 4

Boards' understanding of potential business disruptions is highly variable.

Boards' understanding of potential impact of each disruption on organizations' business,
% of respondents[1]



[1] Respondents who answered "other," "don't know," or "none of the above" are not shown; n = 928. Excludes respondents from not-for-profit organizations.

According to respondents, boards' knowledge of these disruptions is highly variable (Exhibit 4). Across disruptions, they are most likely to understand changing customer behavior, with two-thirds of directors rating their understanding as somewhat or very good. Perhaps not surprisingly, they most often report a poor understanding of cybersecurity, activist investors, and digitization. For each of the nine disruptions, directors are likeliest to say their boards understand the topic when they also say it appears on the agenda.

No real change in the order of boardroom business

The nature of directors' work—including where board members invest their time, how much overall time they dedicate to board work, and how well they understand their organizations' business—has

changed only slightly compared with previous surveys (Exhibit 5).[7] Since 2013, strategy and performance management have been the areas on which boards spend the most time during meetings. Still, respondents would like to spend even more time on strategy as well as on organizational matters, such as structure, culture, and talent management. Furthermore, board members are spending less of their time on board work than before. On average, directors now say they spend 24 days per year on board matters, compared with 26 days reported in 2015.[8] Respondents also report a decline in their ideal number of days spent on board work, although there remains the six-day gap between actual and ideal days spent that we previously saw. Ideally, directors now want to spend 30 days on their board work.

Looking ahead

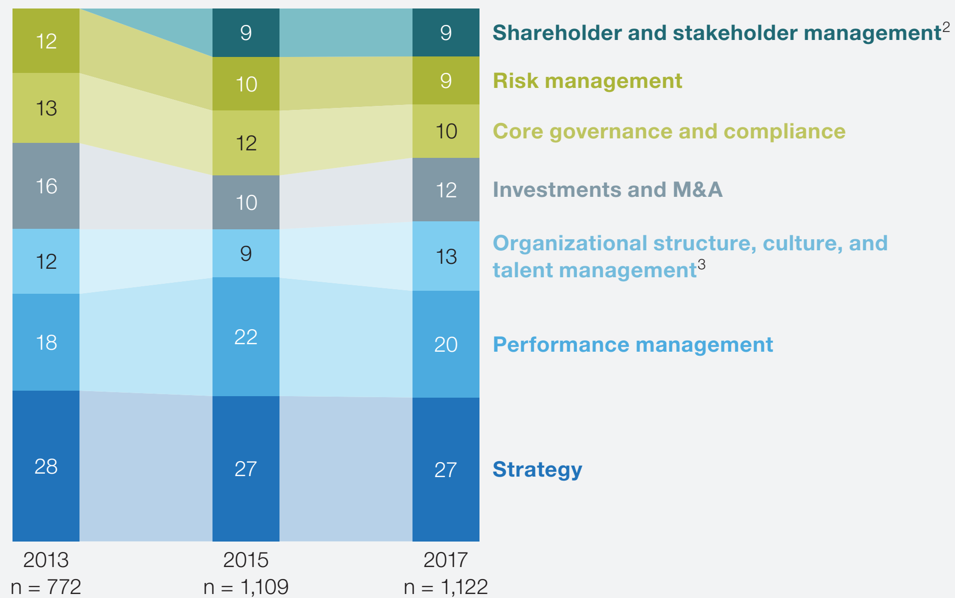
Based on the survey results, boards can take several steps to improve their effectiveness and have greater impact on their organizations' value creation:

- *Make board processes more effective.* Out of the three dimensions of board operations the survey covered, effective processes emerged as the most challenging. Many respondents report effective leadership of their boards, which is key to strong overall board performance and has meaningful impact on the organization's

Exhibit 5

Strategy and performance management remain the topics on which boards spend the most time.

Time boards spend on each topic during meetings,[1] %



[1] Figures may not sum to 100%, because of rounding. Respondents who answered "don't know" are not shown.
[2] Not offered as a topic in 2013.
[3] In 2013 and 2015, topic was called "Organizational health and talent management."

value creation. But in other aspects of how the board works, the results suggest room for improvement. One area is the quality of induction training, during which directors acquire a good understanding of the organization and the industry. Another is ongoing access to development opportunities so directors can continue learning and improving their contributions to the board. Finally, establishing regular feedback processes and a long-term board-succession plan can make a meaningful difference.

- *Make more time for boardroom business.* A notable gap persists between the number of days directors spend on their board work and the number of days they would like to spend on it. In our experience, the amount of time required to be an effective board member is usually more than directors initially expect. While some board members invest significantly more time than the average number of days reported in the survey, others would benefit from spending more time in meetings (for example, to discuss strategic alternatives) as well as learning more about the business and preparing themselves before meetings (for example, visiting company facilities or researching industry competitors). To become a true sparring partner for the management team, many board members would benefit from a better understanding of the company and the industry—in particular, the key value drivers of the business, the relevant risks, and the organization's talent situation.

- *Rethink the annual agenda.* It is not enough for directors simply to dedicate more time to their board work. Equally important is choosing how to spend that additional time and aligning the annual agenda with their companies' strategic priorities. The results suggest that many boards could benefit from focusing more on long-term CEO-succession planning, reviews of core risks, and discussions about the talent pool—all of which are core activities at which many boards are not especially effective.[9] Boards also should leave enough room on their agendas to cover potential disruptions to the business. No company is fully immune to the effects of cybersecurity, digitization, and geopolitical risks, so these topics should be on every board's agenda. Because companies' businesses evolve and potential disruptions can arise at any time, it is important that boards maintain flexible agendas rather than become prisoners of their annual schedules. ■

---

[1] "The CEO guide to boards," *McKinsey Quarterly*, September 2016, McKinsey.com.

[2] The online survey was in the field from April 18 to April 28, 2017, and garnered responses from 1,126 board directors representing the full range of regions, industries, company sizes, and board roles; 31 percent of respondents are either board chairs or lead independent directors, and we asked respondents to answer all questions with respect to the single board with which they are most familiar. We excluded responses from directors on not-for-profit boards in the first two sections of the report, which covered topics relevant to private-sector boards. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

[3] Financial performance is measured as self-reported organic revenue growth, profitability, and change in market share relative to industry peers in the past three years. To control for potential biases (for example, board chairs tending to report better financial performance than other respondents do), we defined two control variables: the respondent's job title and his or her role on the board (for example, chair, vice chair, or lead independent director). Before running the financial-performance analysis, we confirmed that the best- and worst-performing companies have an equal distribution of job titles and board roles across all quartiles. We define an outperforming company as one that, according to respondents, has seen higher or much higher performance on average across three measures—organic revenue growth, profitability, and change in market share—in the past three years, relative to industry peers.

[4] With respect to dynamics and processes, the top-quartile boards are those in which respondents agree with eight or more of the 14 statements we asked about, while the bottom-quartile boards are those in which respondents agree with only three or fewer of the statements.

[5] The survey asked about 42 different board activities related to strategy, performance management, investments and M&A, risk management, shareholder and stakeholder management, and organizational structure, culture, and talent manage-

ment. With respect to board activities, the "top-quartile boards" are those where respondents are effective or very effective in 26 or more of the 42 activities we asked about, and respondents on the "bottom-quartile boards" are effective or very effective in 13 or fewer activities.

[6] Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," *McKinsey Quarterly*, February 2018, McKinsey.com.

[7] Responses from directors on not-for-profit boards are included in this analysis, so the results are more comparable with those from previous years.

[8] Since the 2011 survey, directors have been asked to write in the number of days they spend on board work, both currently and ideally. In the most recent survey, we have used a different methodology to calculate the results. We have removed respondents from our analysis who met the following criteria: those who say four days or less or 101 days or more to the "actual days spent on board work" question, those who say 121 days or more to the "ideal days spent on board work" question, and those who did not answer both questions. When comparing previous results with those from the latest survey, we have applied the same methodology to the write-in responses from 2013 and 2015.

[9] Dominic Barton, Dennis Carey, and Ram Charan, "An agenda for the talent-first CEO," *McKinsey Quarterly*, March 2018, McKinsey.com.

The contributors to the development and analysis of the survey include **Martin Hirt**, a senior partner in McKinsey's Taipei office; **Frithjof Lund**, a partner in the Oslo office; and **Nina Spielmann**, a specialist in the Zurich office.

They wish to thank Michael Birshan, Georg Andreas Gundersen, Geir Holom, Conor Kehoe, Julius Nagel, Sven Smit, and Jørgen Kjoshagen Trømborg for their contributions to this article.

Copyright © 2018 McKinsey & Company.
All rights reserved.