McKinsey Global Survey results

Governance since the economic crisis

Corporate directors know what they should be doing. But they haven't raised their game since 2008 and must strengthen their capabilities and spend more time on board work.

Corporate boards are under pressure to take more responsibility for developing strategy and overseeing business risk after the financial crisis exposed many cases of inadequate governance.[1] Yet, according to the latest *McKinsey Quarterly* survey on governance,[2] directors report that their boards have not increased the time spent on company strategy since our previous survey, conducted in February 2008—seven months before the collapse of Lehman Brothers. Moreover, 44 percent of respondents say their boards simply review and approve management's proposed strategies. Just one-quarter characterize their boards' overall performance as excellent or very good; even so, the share of boards that formally evaluate their directors has dropped over the past three years.

In this survey, we asked directors how much time their boards spend on different activities, how well they understand the issues their companies face, and what factors they think would be most effective in improving board performance. The picture that emerges is that boards have taken to heart the new and higher demands placed on them. But some directors say they feel ill equipped to live up to these expectations because of inadequate expertise about the business and the lack of time they can commit to their board duties, which they say is less than ideal for them to cover all board-related topics in proper depth.

The most effective remedies, respondents say, would be to spend more time overall on board work, improve the mix of skills or backgrounds on the board, and have tougher and more constructive boardroom discussions.

[1] See, for example, "Corporate governance in financial institutions: Lessons to be drawn from the current financial crisis, best practices," European Commission working paper, June 2010; and "The Financial Crisis: Inquiry Report," US Financial Crisis Inquiry Commission, January 2011.

[2] The online survey was in the field from April 5 to April 15, 2011, and received responses from 1,597 corporate directors, 31 percent of them chairs. We asked respondents to focus on the single board with which they are most familiar. Respondents represent 545 family-owned businesses, 334 firms owned by private equity firms, and 330 publicly owned companies; the remainder work at other privately owned or government-owned firms. They represent the full range of regions, industries, and company sizes.

Jean-François Martin

Developing strategy

In our 2008 survey, more respondents wanted to increase the amount of time their boards spent on strategy development and talent management than on core governance and compliance, execution, or performance management. Interestingly, in this year's survey, directors say their boards are now spending roughly the same amount of time on strategy (23 percent of board time, versus 24 percent in 2008) and talent (10 percent, versus 11 percent) that they were three years ago. With the lack of progress, it's not surprising that two out of every three directors still say they want to focus more on these two areas, with a slightly lower share saying they would like to spend more time on business risk management (Exhibit 1).

Exhibit 1

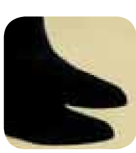
Shifts in strategy and talent

% of respondents

How would you shift the amount of board time spent on each activity over the next 2–3 years based on the activity's relative value to the company?[2]

	% of time board currently spends on issue[1]	Increase	No change	Reduce
Strategy, n = 1,535	23	70	25	4
Execution,[3] n = 1,523	22	42	36	20
Performance management, n = 1,509	18	47	35	17
Core governance and compliance, n = 1,491	14	32	42	23
Business risk management, n = 1,500	14	64	28	6
Talent management, n = 1,469	10	67	24	6

[1]Respondents who answered "other" are not shown.
[2]Respondents who answered "don't know/not applicable" are not shown.
[3]For example, prioritizing key initiatives against strategy, approval of M&A transactions.



The amount of time spent on these areas differs by overall board performance, and directors at underperforming boards see a greater need than others to do better: 78 percent of them want to spend more time on strategy, compared with 65 percent of directors who view their boards' performance as excellent or very good and say the same.

Inadequate time spent on strategy is likely one reason many respondents say their boards play a passive role in developing strategy (Exhibit 2).

Exhibit 2

Passive strategy-making

% of respondents,[1] by location of company headquarters

■ Largest share in each location

Corporate board's role in formulating strategy

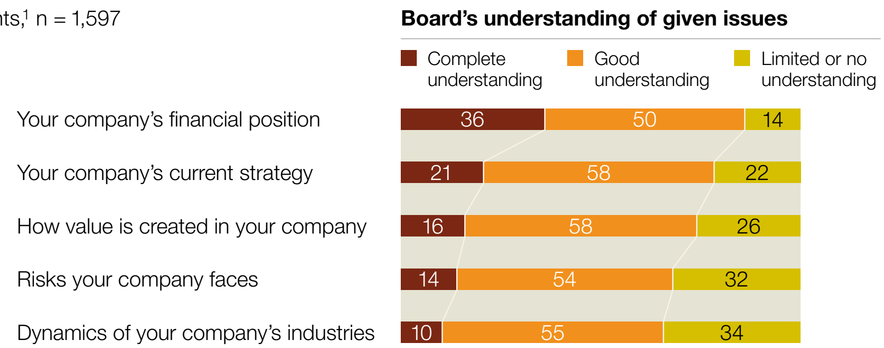
	Total, n = 1,597	**Asia-Pacific,** n = 171	**Developing markets,**[2] n = 185	**Europe,** n = 581	**India,** n = 87	**Latin America,** n = 83	**North America,** n = 490
Reviews and approves management's proposed strategy	44 ■	32	39	37	58 ■	35	57 ■
Develops strategy with management	41	54 ■	41 ■	45 ■	36	45 ■	35
Develops strategy, which management executes	11	12	19	14	7	14	4

[1]Respondents who answered "other" are not shown.
[2]Including China.

Exhibit 3

Knowledge is lacking

% of respondents,[1] n = 1,597



[1] Respondents who answered "don't know" are not shown; figures may not sum to 100%, because of rounding.

Understanding the company

It stands to reason that corporate directors need to know their companies and their industries very well if they are to challenge management on strategic issues, yet that knowledge is often lacking. The results indicate a need to better educate boards on industry dynamics and how their companies create value, among other core issues where respondents say their boards' knowledge is incomplete (Exhibit 3). Only 21 percent of directors surveyed claim a complete understanding of their companies' current strategy.

Respondents on boards in the financial sector, where many boards failed to prevent management forays into risk-laden subprime mortgages before the 2008 crisis, indicate that directors' knowledge is below average on industry dynamics (just 6 percent claim to have complete understanding) but slightly above average on company risk (17 percent).

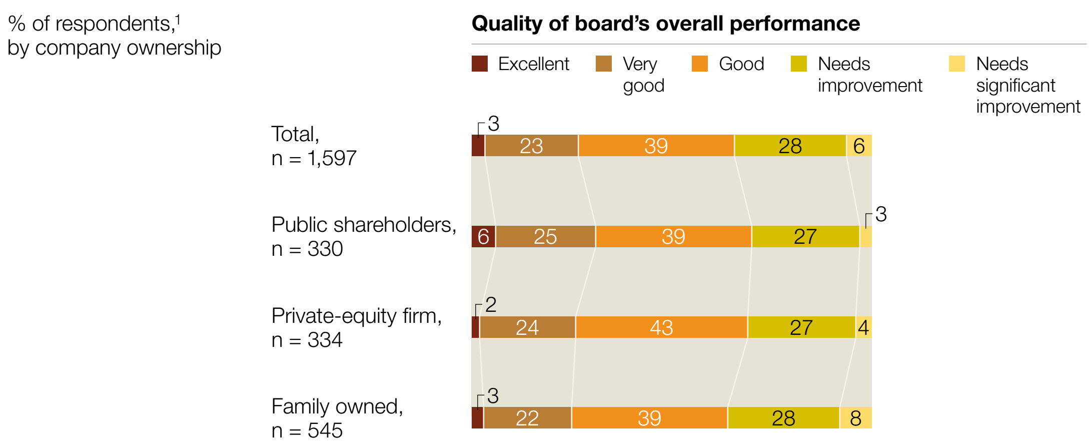
Half of all directors say the information they get is too short-term. These responses resonate with calls from governance oversight bodies for boards to take a greater role in developing long-term strategy. Directors who describe their boards' overall performance as excellent or very good are happier about the time frame of the information they receive—though a third of those respondents still say it is too short-term.

Improving board performance

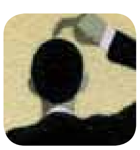
Insufficient time spent on key issues (strategy, risk, and talent) and inadequate knowledge (about their companies and industries) are probably two important reasons why just 26 percent of respondents characterize their boards' overall performance as excellent or very good (Exhibit 4). Directors at publicly owned companies—the category that has been the

Exhibit 4

Room for improvement



[1] Respondents who answered "don't know" are not shown; figures may not sum to 100%, because of rounding.



most frequent target of criticism and regulated governance reforms—are more positive about their boards' performance than their peers at private equity firms and family-owned businesses. This is notable, since companies in the latter two categories have been widely perceived to enjoy superior governance due to stronger owners and more active boards.

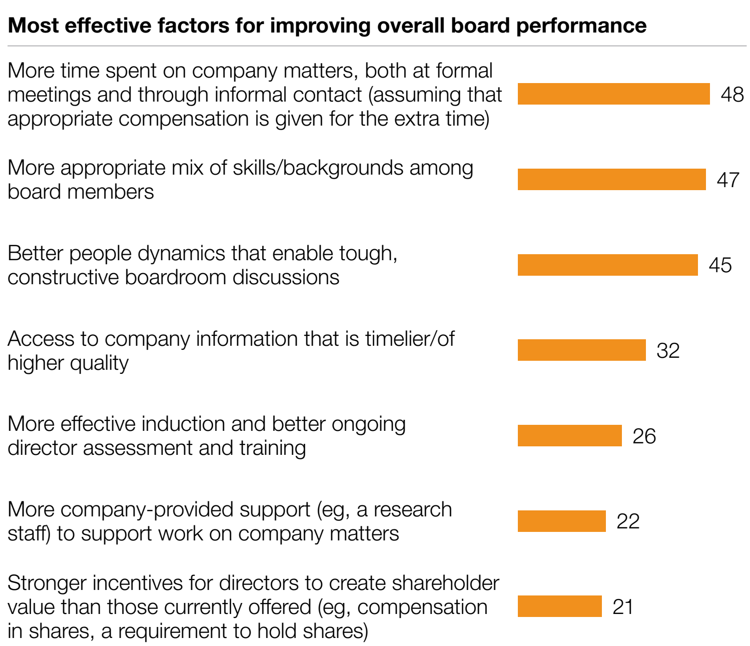
How can boards of all categories raise their game? Among the survey's options for improving performance, the one selected by the most respondents was to spend more time on company matters, both at formal meetings and through informal contact (Exhibit 5). Directors[3] say that on the whole, they're putting in 28 days' worth of work and should ideally spend 38 days to discharge their responsibilities effectively; chairs put in 36 days and should ideally spend

[3] The original group of respondents was sent a follow-up survey with five questions—three of which asked about time spent on board work—that was in the field from June 6 to June 10 and received 625 responses.

Exhibit 5

How to get better

% of respondents,[1] n = 625



[1] A revised version of this question, with three additional answer choices, was asked as part of a short follow-up survey, which all respondents to the original survey were invited to take; respondents who answered "other," "none," and "don't know" are not shown.

Exhibit 6

More time needed

% of respondents	Average number of days directors currently spend on board work	Average number of days directors believe they should ideally spend on board work
Total, n = 625	28	38
Board chairs, n = 170	36	47
All other directors, n = 455	25	35

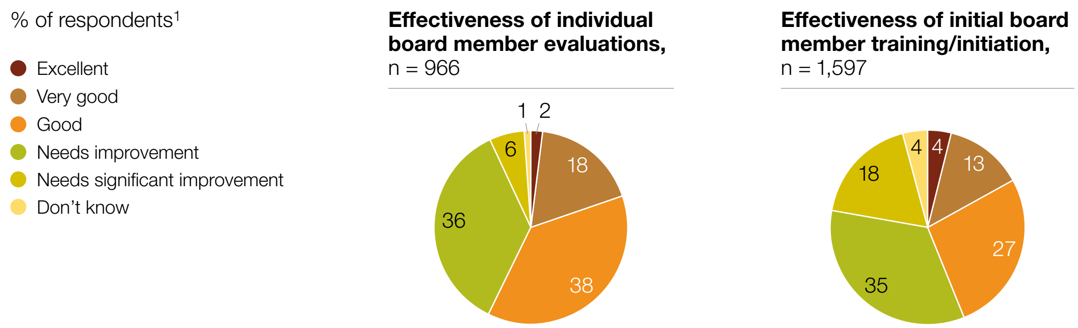
47 days (Exhibit 6). More time overall would presumably help directors cope with core governance and compliance duties and still be able to deal with strategy, risk, and talent issues more thoroughly than before. It's also a logical expectation on the part of directors that if they spend more time on company issues, they will receive more compensation in return: respondents report that they are being compensated for roughly 25 days of work per year, or 11 percent less time than they're actually spending.

Many directors also call for better people dynamics that enable tough and constructive boardroom discussions. This factor is the one where there's the biggest difference between boards that respondents say need to improve or improve significantly (44 percent prioritize it) and boards rated by their directors as excellent or very good (26 percent highlight this need).

Among directors at excellent or very good boards, 12 percent didn't identify a single area in which their boards could improve.

Exhibit 7

Professionalizing the board

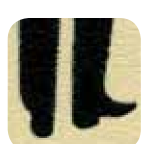


[1] Figures may not sum to 100%, because of rounding.

More effective director training was cited about half as frequently by respondents as a factor that could improve performance, but training and director assessments are key parts of new codes designed to professionalize boards, such as the UK Corporate Governance Code.[4] Indeed, other results indicate considerable room for improvement at most companies. One-third of boards never evaluate individual directors, for example, and among those that do, 42 percent of board members view those evaluations as ineffective (Exhibit 7). Similarly, more than half of respondents report a need for improvement in the training of new members on their boards.

On the whole, board chairs report a slightly rosier view. They tend to be more positive than nonchairs on the effectiveness of training programs, the frequency of director evaluations, the effectiveness of information provided to their boards, the extent of their boards' role in developing strategy, and overall performance. Given the differences, these results emphasize that many chairs may need to take a more honest look at how their boards are performing and what they need in order to perform at a much higher level.

[4] Released in 2010 by the Financial Reporting Council, an independent UK regulator.



Looking ahead

- Most boards say they want to spend more time on strategy development, risk, and talent management, which may require meeting more days per year and companies compensating directors for their extra time spent. Boards could also shift time in each category toward high-impact areas—in strategy, for example, toward long-term trends that could disrupt the current business model.

- At many boards, there is plenty of room to improve understanding of industry dynamics, risk, and value creation. Enhanced training of new directors and better information is one way forward, but boards may also need to shake up their composition by increasing the number with a background in the company's industry, where board knowledge seems particularly lacking.

- Many directors are calling for more constructive board discussions. High-quality debates can be fostered by methods such as challenging the key assumptions behind management's proposals, exploring various biases that board members bring to the table, and conducting annual evaluations of individual directors to assess the degree to which they contribute. □

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