European Board Directors Lag North American Counterparts

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Survey of board directors in Europe uncovers startling shortcomings that could be undermining their effectiveness.

One of the lesser known secrets in corporate governance is the high quality of governance in Canada. Just north of the USA border, Canada has not suffered to the same extent from the limited governance in the US financial sector (and this extends to regulation and government); far from it. These differing standards motivated the **INSEAD Corporate Governance Initiative** and the Clarkson Centre for Business Ethics and Board Effectiveness at the Rotman School to more closely compare European and Canadian boards.

A survey of the two countries' boards found that European board directors lag behind both their Canadian and U.S. counterparts in governance practices. European directors, when reporting on what they see in their board rooms, on average lack understanding of their company's industry, act too much like managers rather than board members and don’t spend enough time on their director duties.

Canada is widely regarded as an exemplar in corporate governance. It is at the very top of ISS governance rankings for best practice adoption of governance practices, with the U.S. placed second followed by European countries.

This benchmarking matters because when we compare the responses to the same questionnaire, Canadian directors appear to place more importance on key areas than their European counterparts.

Europe vs. Canada

Responses to the survey showed Canadian directors are more likely than Europeans to believe a lack of experience as a director impeded their performance. Canadian directors also seem to have more expertise of their industry when appointed to a board role.

A revelation from the research is the lack of importance European board members place on executive sessions, where directors can speak freely and privately. Canadian boards place more than three times the importance in this area.

One aspect where Europeans appear to be doing better than their Canadian counterparts is the area of gender diversity. Canadians show more ‘tokenism’ than the relatively more genuine effort that is developing in gender diversity at European board level - a change that originated in Norway about a decade ago and has now spread throughout Europe.

The distribution of female presence on boards is different: in Canada, more boards have at least one female director, while in Europe more boards have several female directors. And yet, an underlying trend is that almost half of European directors admit the boards on which they sit have no female representation at all – an indication of the road left to travel.

Room for improvement

When it comes to board processes, and succession planning in particular, there is much room for improvement. Formal CEO evaluation processes are few and far between among European boards. Given how costly bad board decisions can be for an organisation in terms of time, reputation and trust, this phenomenon is unusual and only adds to the argument that EU board members can learn from their Canadian peers.

Surprisingly European directors seem more confident in CEO pay/performance alignment than their Canadian counterparts. This suggests that US influences regarding inflated pay expectations by CEOs is more prevalent in Canada than in Europe where social pressures are greater, particularly in family firms which are more prevalent in Europe than Canada.

Lack of formality in board nominations is another area of concern. Two thirds of director nominations in Europe are done through directors' personal contacts rather than through management recommendations or search firms. The concern here is that informality could become improvisation due to last minute reactive decision-making, suggesting that high performing directors are not being identified and opportunities are being lost.

Assessing the strengths and weaknesses within a board would seem a pre-requisite to an enlightened nomination process. Yet only one fifth of European directors reported that their companies have formal board and director assessments. Their arguments for limiting the tenure of board members could, in effect, be recognition of insufficient process management at board level and an acceptance that regulation is a possible solution.

A case for education

There is an obvious case for European directors to take on some form of training. The enduring myth of shareholder supremacy prevails. European directors put major shareholders as their first 'duty of care'. This has to be corrected so that directors understand their responsibility is to the organisation and to the multitude of stakeholders, not just one, albeit important, group of interested parties.

When questioned on how much time they would like to spend on their various director duties, Europeans indicated they would like to spend as much time on education/training as they do on routine items and would be happy to spend double the amount of time they currently allocate. This falls in line with Canadian and U.S. directors' views on education where it's commonly believed all directors should attend training on an annual basis.

Finally, the views of European directors and their North American counterparts are aligned when it comes to what time should be spent on various items: in both countries strategic planning comes out as number one priority. They would be happy to spend marginally less time on financial matters in order to allow strategy to take precedence. This is an encouraging sign that boards are aware of their responsibilities as strategic stewards.

In summary, European directors have shown room to grow and commit to the role. They recognise their shortcomings and have shown a willingness to learn. They see the value in formalised processes but for the moment do not appear to put these words into action. In this ‘EU-Ryder Cup in Governance Effectiveness’, Europe still needs to get out of the rough.

The benchmarking survey was sent out to the global INSEAD Alumni database and participants of the INSEAD International Directors Programme in October last year. The findings are based on the responses of 294 replies from 20 European countries.

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