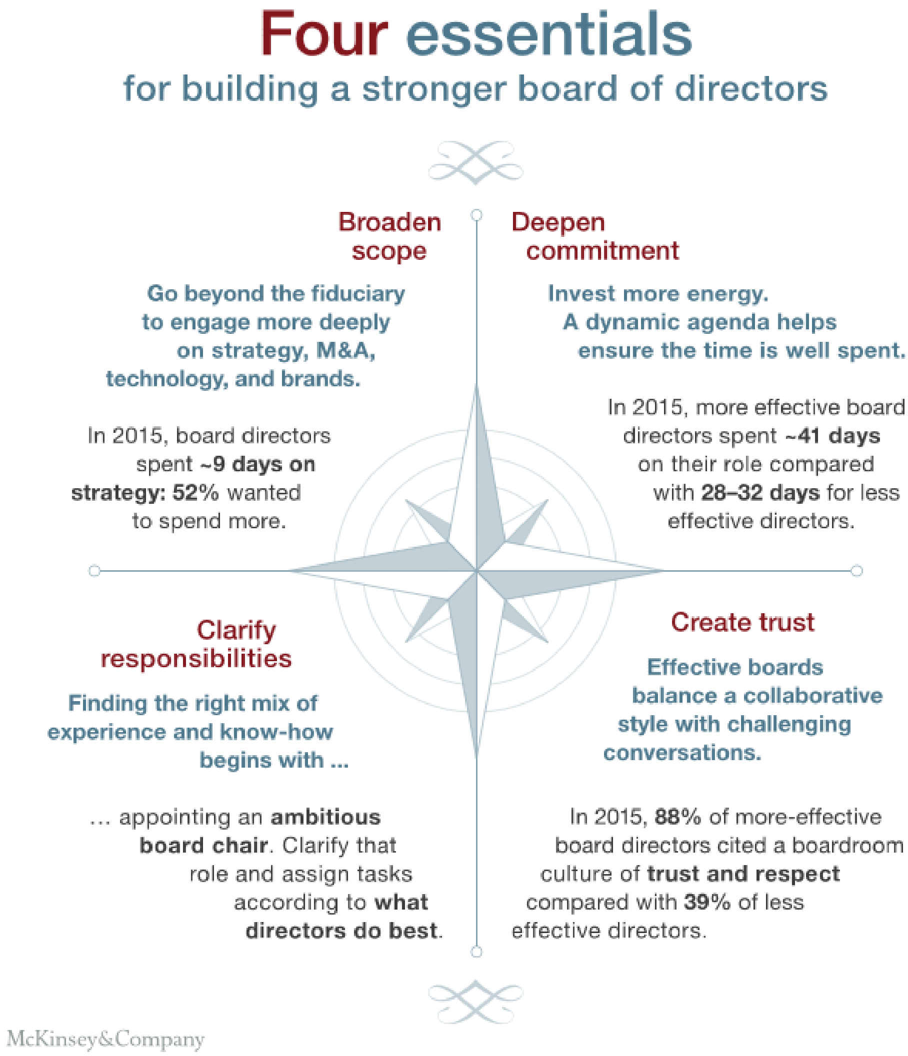
Greater responsibilities require increased commitments of time and energy.

Building a strong board of directors never seems to get easier. High-profile board failures, the boom in activist investing, and the disruptive forces of technology are only a few of the reasons effective board governance is becoming more important.

Start with oversight, a role of the board that, most directors would agree, is no longer its sole function. Directors are now required to engage more deeply on strategy, digital, M&A, risk, talent, IT, and even marketing. Factor in complexities relating to board composition, culture, and time spent—not to mention social, ethical, and environmental responsibilities—and the degree of difficulty continues to rise.

To help CEOs and board chairs, as well as executives and directors, build strong boards, this CEO guide synthesizes multiple sources to make quick sense of complex issues in corporate governance, while focusing on four areas that are essential for building a better board. (For a quick read of these topics, see the summary infographic, "Four essentials for building a stronger board of directors.")

Infographic



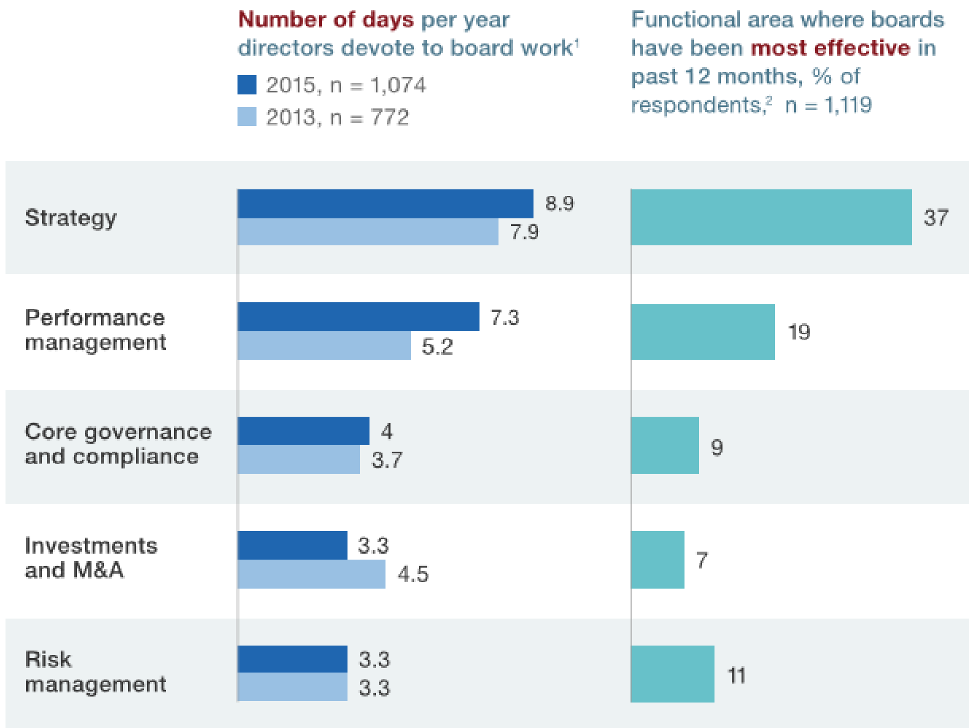
Broaden the board's scope

McKinsey Global Surveys indicate the best boards go beyond fiduciary responsibilities to take a more active role in constructively challenging and providing input on a broader range of matters. Since some of these are also the province of executives, finding the right place to draw the line between governance and management is as important for senior executives as it is for directors. Strong collaboration between the CEO and board chair can help define a broad and forward-looking board agenda, one that, rather than pressuring management to maximize short-term shareholder value, instead helps the company thrive for years.

Contribute the 'outside view' to strategy. McKinsey's recent board survey shows that strategy is, on average, the area boards give most of their attention. Yet directors still want to increase time spent on strategy (Exhibit 1). The board member's role in strategy is to provide the overall strategic framework, to contribute an outside view that challenges the strategic alternatives presented by management,[1] 1.The concept of inside and outside views is explored by Daniel Kahneman in his book *Thinking Fast and Slow* (first edition, New York: Farrar, Straus and Giroux, 2011), which builds on his award-winning article with Dan Lovallo, "Timid choices and bold forecasts: A cognitive perspective on risk taking," *Management Science*, Volume 39, Number 1, January 1993. and, ultimately, to approve the chosen strategy. CEOs should help make sure their own boards are playing this valuable role.

Exhibit 1

Directors spend more time on strategy now than in 2013—and tend to say it's where their boards make their biggest contributions.



[1]Respondents who answered "don't know" are not shown.
[2]Respondents who answered "none" or "don't know" are not shown.

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Bring your board into the digital age. Getting more deeply involved in strategy and other matters will require many board members to increase their digital literacy. More than a few directors are feeling outmatched by the ferocity of changing technology, emerging risks, and new competitors. Reflecting on the digital skills most relevant to individual business lines is one way boards can raise their collective understanding of technology and generate more productive conversations with management.

Ask the right questions about technology. Successful boards must also ask broader questions about technology and IT strategy. Deeper board involvement provides a mechanism to cut through company politics and focus executives on the big, integrated technology investments needed as digital weaves ever further into the fabric of today's businesses. This in turn requires that CIOs, business executives, and board directors develop a shared language to discuss IT performance. Five crucial questions can help steer boardroom conversations toward not just the costs but also the capabilities and value that IT engenders.

Examine M&A through a long-term lens. Some executives believe board involvement in M&A encroaches on the line that separates governance from management, but boards have (and should have) the final responsibility to review and approve any M&A deal. While senior executives can be motivated by shorter-term incentives, board directors are well placed to take a long-term view of a deal's value, and to challenge biases that can cloud M&A decision making and goal setting. They can also embolden senior management to pursue promising deals that may seem unfashionable or be unpopular initially with investors. Strong boards also help companies overcome resource-allocation inertia. McKinsey research shows that companies that reallocate more resources earn higher total returns to shareholders.

Involve your board in talent and culture. Most board directors recognize that CEO succession is one of their most important responsibilities, even while the incumbent CEO plays a critical leadership role in preparing and developing candidates (recent research shows some 86 percent of new CEOs are hired from within). Beyond CEO succession, boards are well positioned to focus on long-term talent development throughout the company, where they can help override some of the personal ties that can influence decisions on important hires and appointments. Boards should also (and, in fact, are required by regulations to) play a key role in defining and establishing an effective corporate culture.

Safeguard the brand. Many successful companies already view customer engagement as the whole organization's responsibility. A few are involving their boards in marketing, too. Against a backdrop of social media, viral video, and reputational risks, the CEO of one North American manufacturer recently placed the potential for brand-changing events on the board's agenda. The ensuing conversation transcended traditional marketing communications and touched on the company's overall strategy, as well as its approach to crisis response.

Deepen directors' commitment

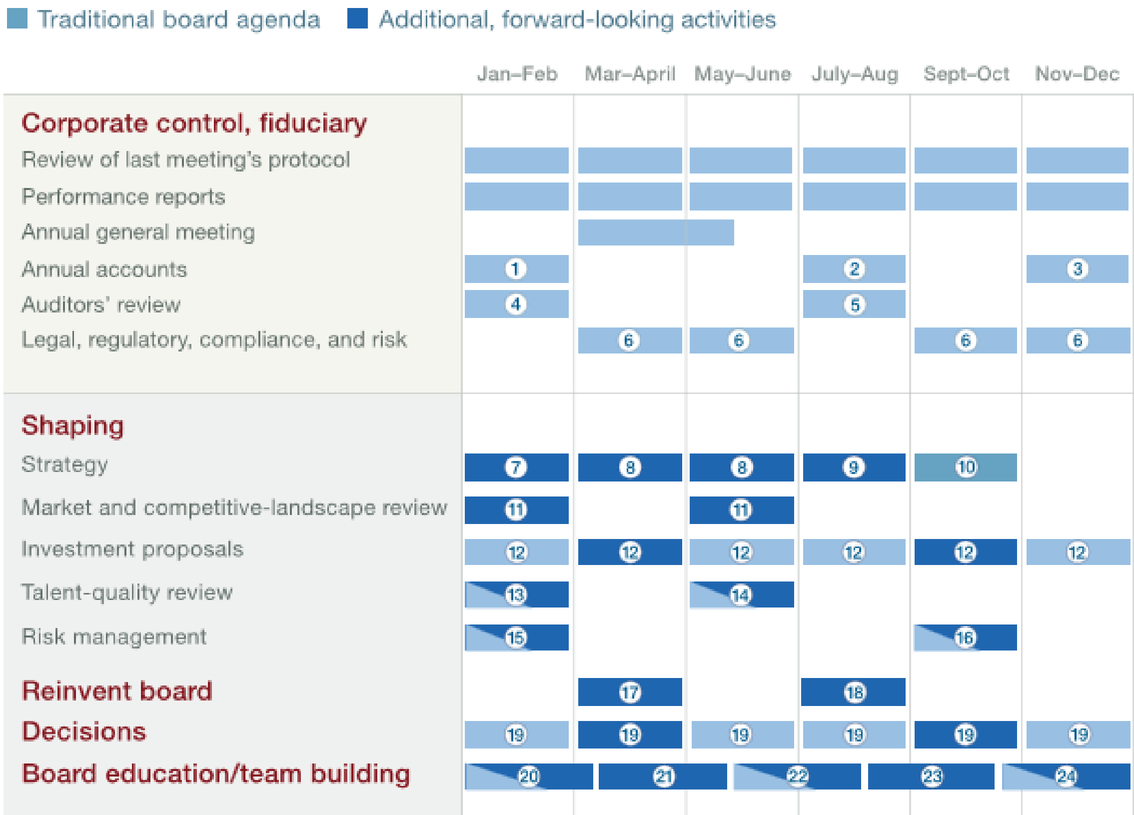
How can boards expand into these new responsibilities while still having time for the traditional fiduciary duties that remain important?

Work more days. Directors at the most effective boards, according to our recent Global Survey results, spend an average of 41 days per year in their role and say they have no ambitions to spend more time. But directors on less effective boards spend an average of 28 to 32 days and say they would, ideally, spend 5 days more. Our own experience is that the time required to do a good job is usually more than directors initially expect.

Develop a dynamic agenda. Given the time constraints board directors face, broadening their role will require developing a dynamic board agenda that explicitly highlights forward-looking activities and ensures these activities get sufficient time over a 12-month period (Exhibit 2). Winning boards will be those that work in the spirit of continuous improvement at every meeting, while keeping long-term strategies top of mind.

Exhibit 2

How forward-looking boards should spend their time.



Details on selected activities (all others are self-explanatory, as labeled)

Fiduciary

1. Annual accounts
2. Annual budget directives
3. Next year's budget
4. Auditors' report
5. Audit-planning approach
6. Audit-committee reviews

Strategy

7. Set framework for the year
8. Define broad options
9. Outline/select options
10. Approve final strategy approach
11. Review strategic and competitive position, key performance indicators

Investment

12. Engage in ongoing review of investment proposals

Talent

13. Set talent-review objectives for the year
14. Review top 30–50 people

Risk

15. Determine risk-review objectives for the year
16. Conduct annual risk review, including mitigation approaches

Board reinvention

17. Conduct board 360° evaluation
18. Determine approach for board-process enhancement

Decisions

19. Engage in decision making—eg, on budgets, investments, M&A, and key nominations

Board education

20. Travel with sales staff, customer visits
21. Visit R&D facilities
22. Visit new geographies
23. Inspect production sites
24. Attend customer conference

Clarify responsibilities and board composition

William George, former CEO of Medtronic and a veteran of ten corporate boards, says one's perspective on board governance depends on the board seat one holds—independent director, chair and CEO, or chair only. Looking at corporate governance through the eyes of each of these positions can help board leaders better see the whole as they look for the diverse mix of experience and know-how that's right for their company.

Appoint an ambitious chair. No matter the title board leaders take, it stands to reason they will have a disproportionate effect on board dynamics. Effective board leaders are those who run meetings well, establish a culture of trust and constructive discourse, and invest in training, development, and feedback.[2] 2.Jonathan Bailey and Tim Koller, "Are you getting all you can from your board of directors?," November 2014. Good leadership sets the tone for the board as a whole and can set the stage for a more effective, value-enhancing board. Finding the right person for this job is important. The process of selecting a board leader has been evolving from an unstructured and haphazard approach toward one that ideally resembles the best practices for CEO succession.

Look for experience and talent. How do you find the right people for board-director positions? And what are the right tasks for them once they are on the board? Even though every board director to some degree needs to be a generalist, each has areas of special expertise, perhaps related to an industry, a function, or a geography. Ideally, the board brings together individuals with the right combination of skills and background. One recommendation is for boards to appoint directors and assign them tasks the same way private-equity firms assign their partners to deals: according to their experience and what they're best at.[3] 3.For more, see Viral V. Acharya and Conor Kehoe, "Board directors and experience: A lesson from private equity" (PDF–380KB), *McKinsey on Finance*, Number 35, Spring 2010.

Clarify what the board leader does. Ever since stock-listing requirements prompted many US companies to name an independent director to serve as the chairman, lead director, or presiding director of the board, these companies have been grappling with what, exactly, the board leader should do and how to find the right person for the job. One survey found that nonexecutive board leaders have taken over or partnered with the CEO on some functions the chief executive has historically led, such as setting board agendas, recruiting new directors, and more aggressively assessing risk.

Create trust by investing in board dynamics

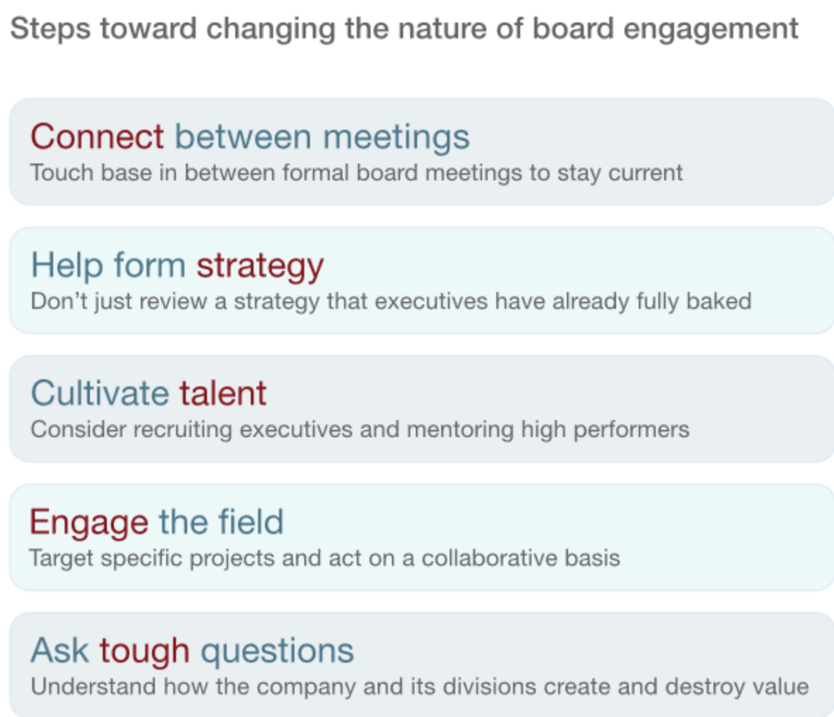
How do you know a board is effective? One litmus test is the growth and involvement of activist investors. If boards were doing their jobs, there would be no activist opportunities, according to David Beatty, Conway director of the Clarkson Centre for Business Ethics and Board Effectiveness at the University of Toronto's Rotman School of Management. Apparently, boards are doing "badly enough that there's been huge growth in activist firms,"[4] 4.Activist investors launched more than 550 activist campaigns around the world in 2015, according to *Activist investing: An annual review of trends in shareholder activism* (PDF–8.26MB), Activist Insight and Schulte Roth & Zabel, 2016, activistinsight.com. says Beatty, who interprets that growth "as a direct comment on boards of directors and their past performance." (When companies do attract the attention of activist investors, they should plan their response tactics thoughtfully toward the most beneficial outcome.)

Balance trust with challenging discourse. According to our recent Global Survey results, the boards that are most effective and well-rounded also have the strongest board dynamics, characterized by openness, trust, and collaborative senior executives and board directors—a group that includes the CEO and the chair, a crucial factor. Directors possessing these collaborative tendencies must balance them by thinking like owners and guarding their authority, or there will be little constructive challenge between independent directors and management, and the board's contribution to the company's fortunes is likely to fall short of what it could be. It's no coincidence, then, that directors at leading boards report these characteristics most often.

Educate and train your board members. To be able to challenge management with critical questions, board members should have a good understanding of the company they serve and regularly compare internal performance data with those of their competitors. Other ways to help board members raise their game include inviting renowned experts to board meetings, holding some board meetings in overseas locations where directors can be exposed to relevant new market developments and technologies, and, from time to time, seeking outside advice to get an independent view.[5] 5.Christian Casal and Christian Caspar, "Building a forward-looking board," *McKinsey Quarterly*, February 2014.

Engage in a continuous improvement process. Providing effective induction training, for example, and conducting regular feedback and board evaluations is something still done by only a minority of boards—even the leading ones, according to our survey results (Exhibit 3). The best boards challenge their members to continually learn, grow, and develop professionally.

Exhibit 3



Source: Bill Huyett and Rodney Zemmel, "Changing the nature of board engagement," *McKinsey Quarterly*, April 2015

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Boards must keep close watch on the shifting nature of their role in today's corporations and find the right balance between governance and management. Greater responsibilities require increased commitments of time and energy, not only during board meetings but also between meetings to stay current and to learn more about the industry, the company, its competitors, and its customers. These responsibilities also raise the premium on carefully protecting the independence that makes boards valuable allies to senior executives, shareholders, and a diverse array of other stakeholders.