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New Corporate Surveys Provide Important Governance Lessons

By Michael W. Peregrine, McDermott Will & Emery

A trio of authoritative new corporate governance surveys provides helpful observations on boardroom trends that are highly relevant to nonprofit health systems. This is particularly the case to the extent that the surveys focus on issues of increasing governance importance to systems; e.g., director time commitment, talent development, executive succession, diversity of composition, information flow, tenure-limiting mechanisms, and outside board service. These are all highly appropriate topics for attention by the health system board, and the general counsel is well suited to present these issues.

About the Surveys

The new surveys include the 2013-2014 NACD Nonprofit Governance Survey (from the National Association of Corporate Directors (NACD Survey)); [\[1\]](#) the 2014 Report on Senior Executive Succession Planning and Talent Development (from the Institute of Executive Development (IED) for Corporate Governance of the Stanford Graduate School of Business (Rock Center Report)); [\[2\]](#) and How Well Do Corporate Directors Know Senior Management (The Conference Board, in consultation with IED and the Rock Center (Conference Board Report)). [\[3\]](#) All survey preparers are highly prominent governance focused organizations, whose work product should have immediate, significant credibility with nonprofit health system boards.

The NACD survey presents findings from its annual questionnaire, which was in process from May to July 2013. [\[4\]](#) The findings are based on 645 organizational responses, reflecting a cross section of the nonprofit sector—with significant response from health care organizations. [\[5\]](#) The survey questions reflected a broad array of leading governance-related issues. This is relevant given the governance effectiveness evaluations that many leading health systems are undertaking in the wake of Affordable Care Act (ACA)-related industry change.

Both the Rock Center and Conference Board surveys focus on matters of executive development, and executive succession, search and selection processes. The data contained in the Rock Report and the Conference Board Report reflect several sources, including (for the Rock Report) older surveys it had conducted that were included to provide historical perspective; as well as new surveys and interviews conducted by Rock Center with IED, and separately, by Rock Center and The Conference Board.^[6] This is particularly relevant given new studies that show the rate of executive turnover is highest in the health care sector.^[7]

Key Observations

The survey observations of likely greatest interest to health system boards include the following:

Director Commitment: The NACD Survey observes a notable increase in the average annual director time commitment, from 146 hours to 163 hours.^[8] This is consistent with surveys conducted by other leading corporate policy groups, and helps to confirm a trend towards greater engagement levels by nonprofit directors in board meetings and processes. This is particularly relevant to nonprofit health systems, where increased system size, ACA-related challenges, more transactional activity, and highly diverse business and investment portfolios are resulting in board agendas of increasing complexity. The expectation—as confirmed to a certain extent by the NACD Survey—is that the time commitment of directors of complex nonprofits, such as health systems, should be commensurate with the sophistication of the organization and its operations. The NACD survey data should be helpful in establishing expectations for the level of health system director commitment, and to the efforts of governance and nominating committees in identifying candidates for board service who have the ability to provide the needed level of commitment.

Board Size: There is certainly no “best practice” when it comes to proper board size for a nonprofit health system. The general expectation is that the board will periodically evaluate whether the current board size is sufficient to allow for effective oversight and decision making, taking into consideration the organization’s size, the nature and geographic scope of its business and mission activities, the regulatory and competitive environments in which it operates, and the pursuit of identified strategic initiatives. Boards that are either “too small” or “too large” for the circumstances may not adequately serve the needs of the organization. For that reason, it is informative that the NACD Survey observes that the size of the average nonprofit board continues to decline, from 19.8 members in 2007 and 17.9 members in 2012 to 15.3 members in 2013.^[9] This may be consistent with a general perception that boards that are “too large” present fundamental barriers to governance effectiveness. Yet, health systems should be

cautioned not to reduce the board size to a level that is insufficient to allow for the proper conduct of the governing board given the size, scope, and circumstances of the system.

Diversity. The governance emphasis on increased diversity in the boardroom also is confirmed by the NACD report. The data suggests that nonprofit boards are much more diverse, in terms of both gender and ethnic areas of classification, than their for-profit peers. The survey data reflects an average of 5.7 female directors and 2.7 directors with minority backgrounds on nonprofit boards.[\[10\]](#) This is consistent with recent, wide-ranging public policy emphasis speaking to the governance benefits derived from increased ethnic and gender diversity on corporate boards.

Tenure Limitation. The ongoing discussion within many boards on the efficacy of term limits and similar measures receives guidance from the NACD Report. According to the data, more than 55% of nonprofits have adopted term limitations or similar board refreshment mechanisms. The survey data also suggests that nonprofits are much more willing than are public and private companies to adopt tenure limitation procedures. Of the identified refreshment measures, traditional term limitations are the most popular, followed by age limits and by “change of status”-based resignation.[\[11\]](#)

Leading Issues. There are also useful lessons to be gleaned from the NACD rankings on those issues that are of high (and low) priority for nonprofit boards. Oversight of strategic planning and operations are historically the leading priorities for nonprofit boards, and that fits well with the related ACA-prompted challenges currently confronting health system boards. Other leading nonprofit governance priorities identified by NACD include board effectiveness, financial oversight/internal controls, and Chief Executive Officer (CEO) succession/director recruitment. On the “flip side,” it is interesting to note those areas that seem to attract substantially less board interest and attention, e.g. IT oversight, crisis oversight, and director education and development.[\[12\]](#) That is a perspective that is decidedly inconsistent with the emerging governance requirements of large, operationally complex nonprofit health systems.

Talent Development: Each of the three surveys suggest that the issue of executive talent management and leadership development is an emerging area of governance attention—but that much work remains to be done before many boards have a proper grasp of the underlying issues, challenges, and opportunities. While the data reflects a general recognition of the importance of succession practices, there appears to an increasing level of concern within boardrooms with the manner in which these practices are being pursued within the organization.

Indeed, the Rock Center Report paints a disturbing picture of the status of talent development/executive session efforts of leading organizations. The survey results

suggest a tendency of directors to “greatly underestimate the difficulty, time and cost associated with CEO and C-Suite succession planning.”[\[13\]](#)

The specific findings of the surveys expand upon that observation. For example, the findings note that companies lack awareness of who is in position to assume senior executive positions; that they lack an actionable procedure by which to select senior executives; and that their succession plans are often designed more to reduce risk, rather than finding the most qualified successors.[\[14\]](#) Other key observations are that succession planning roles are rarely well defined and often are disconnected from coaching and internal development efforts.[\[15\]](#)

The Conference Board Report concludes that most directors lack an extensive exposure to members of the senior leadership team outside of the boardroom environment, and also lack a useful knowledge of the credentials of those executives. This, in turn, hinders effective executive development and succession practices. Accordingly, the Conference Board Report recommends that companies increase both formal and informal interaction between the board and the senior leadership team.[\[16\]](#)

Best Practice?

Of course, it is important to put the observations of these important surveys into the proper perspective, for purposes of board discussion. Reports prepared by commercial policy organizations and academic organizations can make a strong contribution to internal board, and external, discourse on effective governance practices. In addition, they can serve to provide an important frame of reference for what may be considered “normal and customary” governance practices for boards of similarly situated organizations.

However, they are not intended to constitute statutory requirements, nor are they intended to reflect established governance best practices or other forms of aspirational goals. Board members breach no fiduciary duty by failing to adopt processes consistent with these survey results. Yet, their consideration by a health system board should be considered by a regulator, a court, or other third party as consistent with good faith efforts to improve governance effectiveness.

The Role of the General Counsel

The surveys' emphasis on governance engagement in talent development serves to clarify the need for general counsel involvement in the efforts of executive leadership to brief the board on this increasingly important topic. While matters of executive search and succession have in the past been the sole leadership province of the company human resources executive, that is no longer a sustainable position. The surveys make clear that

there are very significant governance implications inherent in talent development efforts, and the general counsel (not the human resources executive) has the unique professional qualifications to advise the board on its fiduciary obligations in this area.

Thus, talent development is similar to matters of executive compensation, in that they both require the expertise of two different skill sets: compensation and benefits, and law. Committees with responsibility for executive compensation and for talent development require the support of both compensation/benefits and legal advisors.

Conclusion

Each of the NACD Survey, the Rock Center Report and the Conference Board Report provide important guidance on governance trends and practices, particularly with respect to how boards develop executive talent and provide for the succession of executive officers. These trends and practices are part of the board's fundamental duty to exercise oversight of the health system. For that reason, it is appropriate for the general counsel—perhaps in consultation with the senior human resources executive—to brief the board on the observations contained in these important surveys.

[1] *2013-2014 NACD Nonprofit Governance Survey* (from the National Association of Corporate Directors (NACD Survey)); available [here](#).

[2] *The 2014 Report on Senior Executive Succession Planning and Talent Development* (from the Institute of Executive Development (IED) for Corporate Governance of the Stanford Graduate School of Business (Rock Center Report)); available [here](#).

[3] *How Well Do Corporate Directors Know Senior Management* (The Conference Board, in consultation with IED and the Rock Center (Conference Board Report)), available [here](#).

[4] NACD Survey, *supra* note 1, at 4.

[5] *Id.*

[6] Rock Center Report, *supra* note 2, at 15; The Conference Board Report, *supra* note 3, at p. 6-7.

[7] See, e.g., Challenger, Gray & Christmas, Inc., Press Release, *2013 November CEO Report: 94 CEO Changes, Health, Gov't Lead*, available [here](#).

[8] NACD Survey, *supra* note 1, at 5, 16-17.

[9] *Id.* at 26-27.

[10] *Id.* at 5, 24-27.

[11] *Id.* at. 5, 24-26.

[12] *Id.* at 8-11.

[13] Rock Center Report, *supra* note 2, at 1

[14] *Id.*

[15] *Id.*

[16] The Conference Board Report, *supra* note 3, at 1-2.

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1620 Eye Street NW
Washington, DC 20006-4010
Phone: 202-833-1100 Fax: 202-833-1105