

The Board of the Future

Prepared for tomorrow's challenges?

2023

Governance Perspectives

Quantitative and qualitative trend analysis of the challenges facing the supervisory boards of German listed companies

The Role of the Supervisory Board in Times of Transformation

Special Challenges for the Work of the Supervisory Board: On the Right Track

The current disruptions and transformation processes, as well as socio-economic volatility, also mean significant changes for supervisory boards. Implemented processes and procedures, as well as the supervisory board's tasks and the current German corporate governance structure are being questioned to an unprecedented extent due to the changes in the economic, technological, and political landscape. The transformation has led to a broad public discourse on how supervisory boards should operate in the future to pursue their activities as effectively as possible regarding the challenges of today and tomorrow. Therefore, the work of the supervisory board has already evolved rapidly, also in view of increased public attention. However, the heterogeneous discourse on the "Board of the Future" shows the desire and necessity for further change.

ECBE Governance Perspectives: Objectives and Approach

In our current Governance Perspectives 2023, we have asked the central question: How must the work of the supervisory board continue to evolve to meet the future requirements and expectations that we place on the supervisory board today?

To answer this, ECBE analyzed and compiled qualitative and quantitative data from various sources in cooperation with the University of Göttingen:

- I. Formulated theses on the role and work of the supervisory board were discussed and questioned in personal conversations with selected supervisory board and committee chairs of German listed companies.
- II. Using publicly available data from supervisory boards collected by ECBE and reviews of scientific studies, the theses discussed with supervisory board and committee chairs were mirrored with empirical findings.
- III. The results were additionally classified with ECBE's experience gained from evaluations or self-assessments of supervisory boards.

Our results show: Supervisory boards are on the right track – and should continue to implement the following overarching themes.



The Key Findings of the Study

1

UNDERSTANDING OF THE ROLE

The supervisory board will intensify its role as a counselor and sparring partner to the management board. Many supervisory board members wish for a greater involvement in strategic issues and the strategy development process. Therefore, the management board should increasingly rely on the expertise and best practice evaluations of supervisory board members.

2

COMPETENCE PROFILE & TEAMING

The supervisory board will invest more time, thought, and commitment in creating candidate profiles and transitioning from reactive to strategic long-term succession planning. Besides professional expertise, the personal characteristics of the new appointments will be crucial.

3

AGILE WORKING METHODS

The supervisory board will be able to react faster to changes and incidents in the company through more agile working methods and a diversified information supply. The interaction of members between meetings, the involvement of external experts, and the establishment of ad hoc committees will play a crucial role in the future.

4

ENGAGEMENT & COMMITMENT

Due to the increased variety of tasks and (regulatory) requirements, the time commitment of supervisory board members will continue to increase. The supervisory board compensation must be adapted to the expectations placed on supervisory board members. The supervisory board members' terms of office will become increasingly individual in the future to enable constant renewal and regular changes in perspective (staggered boards).

The Role of the Supervisory Board: Between Sparring Partner and Controller



Guide and Sparring Partner

According to the supervisory board and committee chairs surveyed, the supervisory board of the future should be more actively involved as a guide and sparring partner in matters concerning strategy and business development. Especially in companies with transformative and disruptive business models, the advisory role should be implemented and more strongly embedded in a "Stand Up" culture, where the supervisory board acts as a critical companion. In this context, the respondents emphasize that the supervisory board must also be willing to promote future innovations that may involve risks or potential errors.

The management board should value the advice of the supervisory board, be open to suggestions, and draw on the expertise and best practice assessments of the supervisory board members. This is particularly important since supervisory board members bring experience from other domestic and international boards. The ECBE analysis of index networking shows that 11 percent of all supervisory board members from DAX, MDAX, and SDAX have at least one additional supervisory board mandate within the DAX family. Moreover, supervisory board members have an average of one foreign mandate.

These statements reflect the assessments that ECBE has obtained through evaluations conducted with supervisory board members: The supervisory board members want to be more involved in strategic issues. In various committees, it is indicated that the supervisory board does not adequately perceive its role as a sparring partner of the management board. In addition, the mutual understanding of the role and contribution of the supervisory board in strategy development and implementation is not regularly discussed.

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Strategy is an iterative process between the management and the supervisory board. The supervisory board should be involved throughout.

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Dr. Werner Brandt
Supervisory Board Chairman



The management should value the advice of the supervisory board and be open to suggestions.

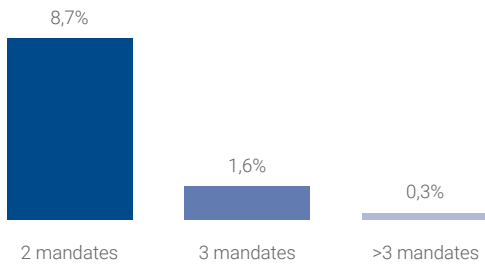


Jürgen Fitschen
Supervisory Board Chairman

Individual Implementation in the Two-Tier System

According to the respondents, the increasing heterogeneity of business models requires an individual and non-standardized implementation that must be captured and implemented by the supervisory board. Thus, further formalization would hinder the substantive work of the supervisory board. The design of structures and processes must be company-specific, but there should be no dilution of structures or responsibilities in the German two-tier system.

Fig. 1: Index networking



Evaluations for Reflecting on Role Understanding

Regular (self-)evaluations of the supervisory board give the board the opportunity to discuss its role and to gain a mutual understanding of further development. In 2021, 75% of DAX companies conducted an evaluation, 27% of which were accompanied by external support. In the MDAX, only 46% conducted an evaluation, 17% of which were accompanied by external support. Among the companies in the SDAX, 60% conducted an evaluation, of which just under 29% were accompanied by external support.

Fig. 2: Supervisory board evaluations in 2021

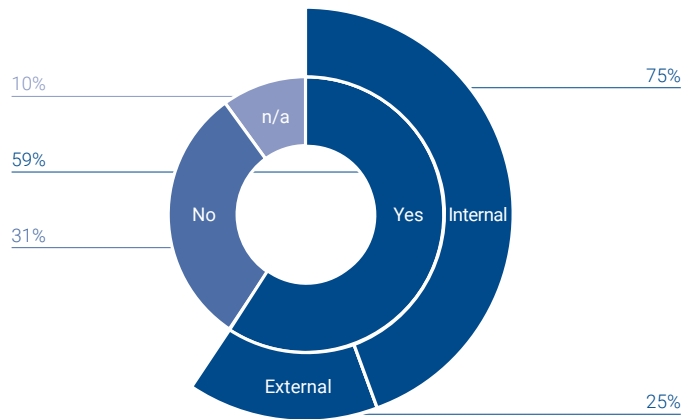
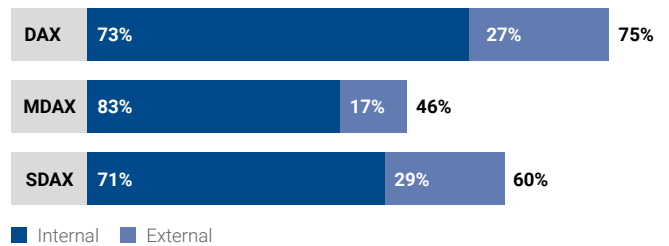


Fig. 3: DAX, MDAX and SDAX evaluations in 2021



Empirical evidence

- Effective boards act as advisors to top management in the development and implementation of the company's key strategic initiatives.**
Klamer et al. (2021): A capability-based view of boards: A new conceptual framework for board governance; Academy of Management Perspectives, Vol. 35 (1): 123-141.
- Boards that actively participate in strategic decision making improve firm performance. The nature of board processes (e.g. board meetings, out-of-board meetings, the way information is used, etc.) influences board involvement in strategic decision making.**
Zhu et al. (2016): Board Processes, board strategics involvement, and organizational performance in for profit and non-profit organizations; Journal of Business Ethics, Vol.136: 311-328.
- Corporate strategies determine the need for board members with specific expertise: Companies looking to expand into foreign markets benefit from board members with regional expertise.**
Chen et al. (2020): Board structure, director expertise, and advisory role of outside directors; Journal of Financial Economics, Vol. 138 (2): 483-53.
- Boards see strategic collaboration with top management as critical to their work, including recognition of the specific perspectives that board members bring to the table.**
Boivie et al. (2021): Corporate directors' implicit theories of the roles and duties of boards; Strategic Management Journal, Vol. 42(9): 1662-1695.

Living the competence profile without neglecting personal characteristics



Development of competence profiles as a continuous process

The competence profiles of supervisory board members are becoming increasingly detailed and more lived out. From the respondents' point of view, the supervisory board will invest more time, thought and commitment in creating candidate profiles. This should be done as part of a more comprehensive long-term succession planning process, moving from a reactive to a strategic approach to succession. The qualification matrix installed by the German Corporate Governance Code as a tool for presenting the competence profile will contribute to an increased transparency and a more regular evaluation of the supervisory board members' professional and personal suitability.

The development of competence profiles should be a continuous process, in which the supervisory board is set up as a so-called "staggered board", allowing for an effective mix of experience and new or external perspectives. The respondents emphasize that the heterogeneity of business areas must be reflected in the competencies of the supervisory board members. In addition, a self-assessment by the supervisory board members and feedback from investors should be sought and considered.

Personalities in the collective are crucial

In addition to professional expertise, the personal characteristics of supervisory board members, such as integrity, critical thinking and communication skills continue to be seen as a crucial factor. The supervisory board should be set up and act as a collective with heterogeneous perspectives. To avoid silo thinking and development, a proper discussion and work culture is critical. Mapping soft skills is seen as a challenge. The chair of the supervisory board should be given a coordinating role to create the right culture in the committee with appropriate consideration of soft skills.

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The heterogeneity of business models needs to be understood by boards – and should be reflected in board competencies.

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Dr. John Feldmann
Supervisory Board Chairman



Personalities matter. The board needs to be a collective with heterogeneous perspectives and act accordingly.

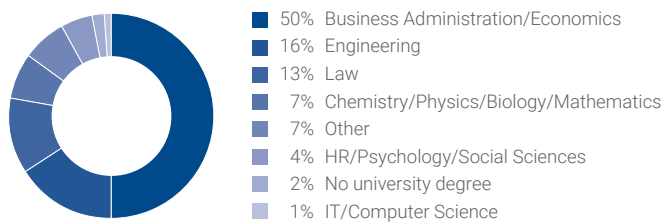


Ursula Radeke-Pietsch
Committee Chair

Positive development of a more diverse composition is recognizable

Our descriptive analysis of the companies in the DAX family shows a positive development of diversity and expertise: The proportion of internationality of supervisory boards is 38 percent in the DAX, followed by the MDAX with 25 percent and the SDAX with 23 percent. A clear positive development of internationality can be seen in the multi-year comparison. The proportion of female supervisory board members has also increased, with 36 percent of shareholder representatives in the DAX, followed by the MDAX with 34 percent and the SDAX with 31 percent. In the five-year perspective, the proportion of female supervisory board members in the SDAX has almost doubled. Overall, an increase of 11 percentage points can be seen over this period. The analysis of the expertise of supervisory board members illustrates an increase not only in those classified as financial experts (34 percent) but also in digital experts (17 percent) and sustainability experts (7 percent).

Fig. 4: Educational background



Talent management

In the future, supervisory boards should deal more intensively with talent management and personnel strategy – not only providing the management board's succession plan. From the respondents' point of view, it is an important task for the supervisory board to evaluate how the management board implements personnel planning and whether the company is attractive to young talent. For this purpose, the supervisory board should also be staffed with members who have the necessary HR expertise. In addition, external HR experts should be used more strongly in the committee's meetings and site visits for personal exchange with the workforce.

Fig. 5: Percentage of certain types of experts

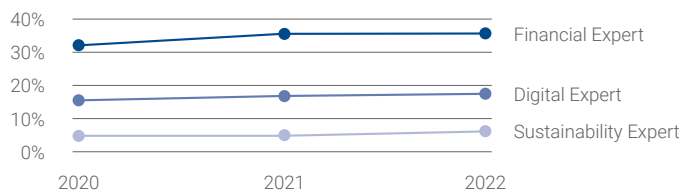


Fig. 6: Percentage of female board members

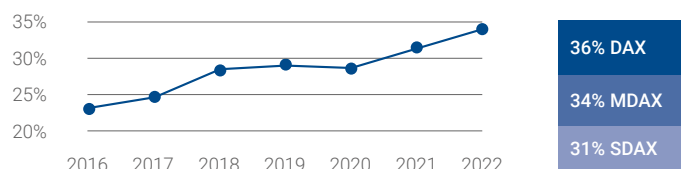


Fig. 7: Percentage of international board members

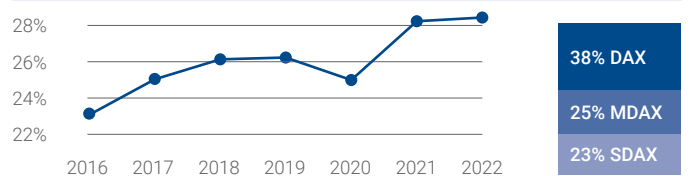
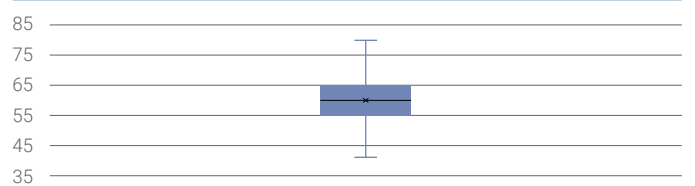


Fig. 8: Age of board members



Empirical evidence

- The expertise of board members should be aligned with the risks of the company: in addition to identifying existing or missing expertise, the board should assess whether this expertise is necessary in view of the current risks.**

Schnatterly et al. (2021): The effects of board expertise-risk misalignment and subsequent strategic board reconfiguration on firm performance, Strategic Management Journal, Vol. 42: 2162-2191.
- Boards should vary in the skillset of their members, as the combination of characteristics is essential for board decision-making.**

Adams et al. (2018): Director skill sets; Journal of Financial Economics, Vol. 130 (3): 641-662.
- Companies are more likely to appoint women to the board if there are more female members on the nomination committee.**

Guldiken et al. (2019): Beyond tokenism: How strategic leaders influence more meaningful gender diversity on boards of directors; Strategic Management Journal, Vol. 40: 2024-2046
- Board members from countries with high levels of genetic diversity improve company performance.**

Delis et al. (2017): Effect of board directors from countries with different genetic diversity levels; Management Science, Vol. 63 (1): 231-249.

Intensify and Diversify Information Supply – Implement Ad-Hoc Committees



More Agile Work: Information Supply

To react quickly and agilely to changes and incidents within the company, the supervisory board has to be provided with up-to-date information. The supervisory board and committee chairs surveyed consider the provision of information between meetings as crucial. In the evaluations accompanied by ECBE, supervisory board members often suggest more regular monthly updates or executive summaries, expansion of non-executive sessions and site visits, as well as more intensive informal exchanges between meetings to be sufficiently informed about the company's situation. In this regard, the supervisory board chairs play a critical role in keeping the board members informed of significant events between the meetings. The respondents also suggest that the management board should proactively approach the supervisory board (through the supervisory board chairs). However, they also note that faster work methods conflict with the meetings' burden of proof. Additionally, information supply between meetings should be targeted to focus on essential information.

Diversify Information Supply

The supervisory board should rely more intensively on internal and external experts or key positions of the company to better classify the reports and presentations during supervisory board and committee meetings. The evaluations carried out by ECBE reveal that these possibilities for additional information supply are still rarely used, but that supervisory board members increasingly desire them. The contribution of expertise within and outside the company should also be actively promoted by the board.

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Ad hoc committees should be staffed according to competence profiles.

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Dr. Werner Brandt
Supervisory Board Chairman

More Agile Work: Committees

To implement a more agile work approach and to actively involve supervisory board members, short-term task groups or ad-hoc committees should be used more in the future. They deal with current topics or exchange ideas with the board. According to the respondents, it is important that responsibility is not shifted to the committees. Decisions should be prepared by the committees but made in plenary. The involvement of the specific knowledge and competencies of supervisory board members between meetings is important from the respondents' perspective. In this regard, particular emphasis should be placed on the individual contribution or expertise and the time availability of each supervisory board member, as well as enabling direct access to relevant company representatives.

The ECBE analysis shows that 55 percent of audit committee members have expertise in accounting (37 percent) or auditing (18 percent). 36 percent of members of digitalization committees were classified as digital experts, while 13 percent



Board members should be actively involved. (Ad hoc) committees can help.



Dr. John Feldmann
Supervisory Board Chairman

of members of sustainability committees are sustainability experts. DAX companies have an average of 4.8 committees, followed by MDAX with an average of 3.5 committees and SDAX with an average of 2.9 committees. The overview of committees over time shows a significant increase in sustainability committees in the last two years.

Fig. 9: Experts on the Sustainability Committee

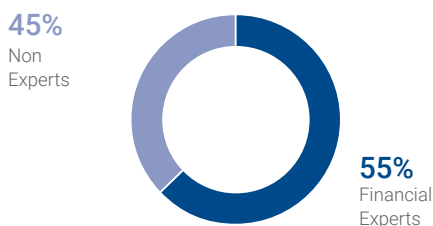


Fig. 10: Experts on the Digital Committee

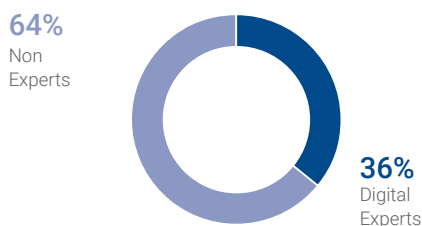


Fig. 11: Experts on the Sustainability Committee

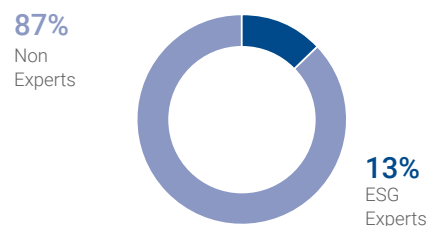


Fig. 12: Average number of committees

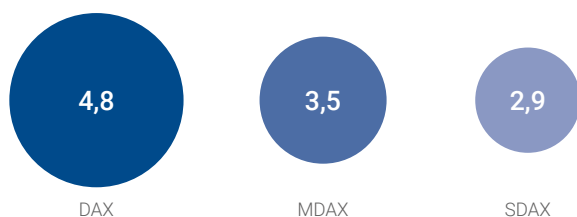
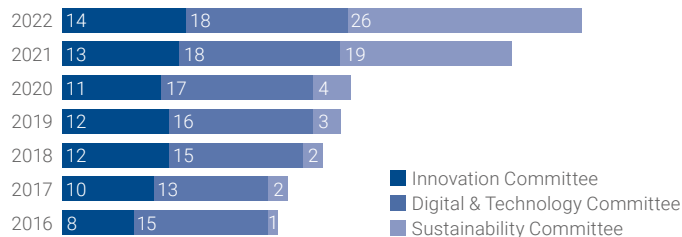


Fig. 13: Number of transformation committees



Empirical evidence

- 1. Communication between board members is crucial to the successful functioning of the board. Non-executive sessions, board retreats and separate committees for specific topics lead to more effective communication.**

Malenko, N. (2013): Communication and decision-making in corporate boards; The Review of Financial Studies; Vol. 27(5): 1486–1532.
- 2. A more cohesive board, working together to achieve goals, will increase board members' efforts to obtain information from the company and top management.**

Du & Xu (2018): The path to independence: Board cohesion, cognitive conflict, and information sharing; Journal of Management Accounting Research; Vol. 30(1): 31–54.
- 3. A balanced participation of board members is associated with higher board effectiveness.**

Pugliese et al. (2015): An observational analysis of the impact of board dynamics and directors' participation on perceived board effectiveness; British Journal of Management, Vol. 26: 1–25.
- 4. Committee structures reduce communication and coordination problems and discourage social loafing.**

Reeb & Upadhyay (2010): Subordinate board structures, Journal of Corporate Finance 16(4):469-486

Expanding and rewarding time commitment – Introducing Staggered Board



Time Commitment

According to the chairpersons of supervisory boards and committees surveyed, the time commitment has increased significantly, as the demand and complexity of tasks, as well as regulatory requirements, have risen. The preparation for board meetings is considered an essential part of the role, as board members are expected to have read the materials beforehand to focus on in-depth discussions. The individual expectations of board members should be explicitly formulated, according to the respondents.

The ECBE analysis shows that in 2021, on average, eight plenary meetings took place in the index companies. A discrepancy can be observed in the number of committee meetings, depending on the number of committees. In the DAX, for example, there were a median of 15 committee meetings held last year, compared to 11 in the MDAX and 8 in the SDAX per supervisory board. The time commitment is also evident in the overview of committee memberships and chairmanships. 46 percent of supervisory board members in the DAX family are represented in at least two committees. 23 percent of supervisory board members are chairs of a committee, and 11 percent are chairs of at least two committees.

Appropriate Compensation?

According to the respondents, the supervisory board compensation is not always appropriate. This perception is confirmed by the evaluations carried out by ECBE. Many board members feel that the required individual commitment and the compensation are not in proportion. They hope for regular review and consideration of market developments. Figure 19 illustrates the average compensation for index companies in 2021, as determined by hkp/// group.

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The variety of topics has significantly increased the time commitment of board members.

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Ursula Radeke-Pietsch
Committee Chair

Staggered Board

In the future, the terms of office for supervisory board members will become more individualized to enable continuous renewal and regular perspective changes. According to the respondents, these so-called staggered boards are also demanded by investors. A suitable mix of experience and competence is crucial. On the one hand, the board needs members with comprehensive and long-standing knowledge of the company, the industry, and internal processes. The respondents suggest that at least 1-2 years are necessary for a member to be established adequately. On the other hand, external experts are needed to complement the supervisory board by being integrated into an established board.

Fig. 14: Tenure

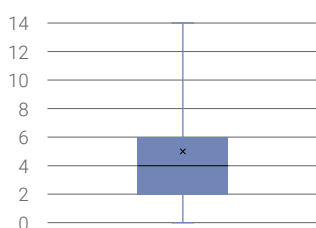


Fig. 15: Board meetings

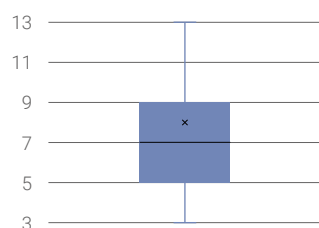


Fig. 16: Committee meetings

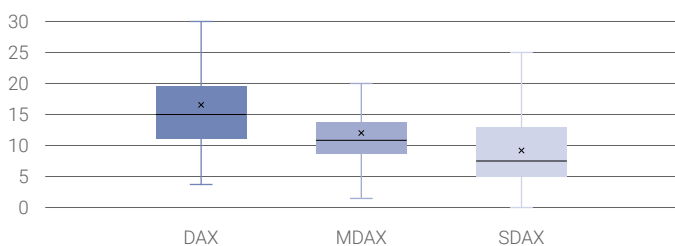
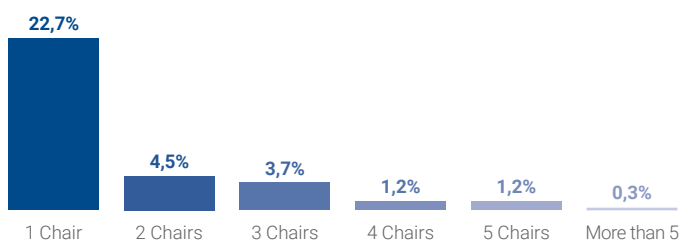


Fig. 17: Number of committee chairs



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Staggered Boards werden immer häufiger implementiert – und auch von Investoren gefordert.

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Jürgen Fitschen
Supervisory Board Chairman

According to the respondents, formal rules are often not helpful. Rather, individual limits should be set so that a certain term of office is not exceeded, as otherwise the critical supervision of supervisory board members could be lost.

The ECBE analysis shows that the average term of office is 5.4 years. The median term of office is 4 years for the DAX, 3 years for the MDAX, and 5 years for the SDAX.

Fig. 18: Number of committee memberships

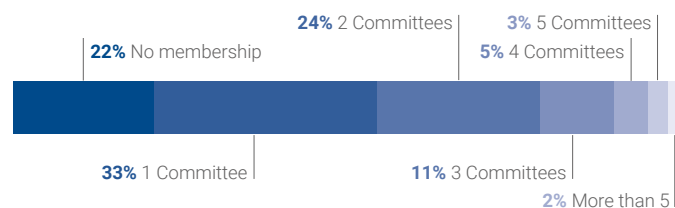
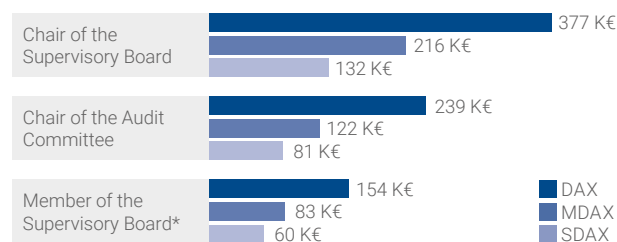


Fig. 19: Average total remuneration



* Exclusive Deputy Chairman of the Supervisory Board. Annual/remuneration reports 2021. Index composition as of 31.12.2021. Only full-year incumbents were considered. (Source: hkp// group).

Empirical evidence

1. Depending on the relative prestige of each board mandate, board members who hold more than one board mandate distribute their workload unevenly.

Masulis & Mobbs (2014): Independent director incentives: Where do talented directors spend their limited time and energy?; Journal of Financial Economics, Vol. 111 (2): 409-429.

2. Chairpersons should take a less visible role in encouraging the contribution or commitment of other board members and thus the strength of the board as a whole.

Bezemer et al. (2018): The influence of board chairs on director engagement: A case-based exploration of boardroom decision-making; Corporate Governance: An International Review, Vol 26 (3): 219-234.

3. There is an inverted U-shaped relationship between board tenure and firm value, M&A performance and accounting quality.

Huang, S., & Hilary, G. (2018). Zombie board: Board tenure and firm performance; Journal of Accounting Research, 56(4): 1285–1329.

4. Better qualified board members receive more board responsibilities and thus higher remuneration.

Fedaseyev et al. (2018): Do qualifications matter? New evidence on boardfunctions and director compensation; Journal of Corporate Finance, Vol. 48: 816–839.

Methodology



The ECBE Governance Perspectives are based on the following qualitative and quantitative analyses:

Qualitative analysis – Personal interviews

In Q3 and Q4 2022, ECBE conducted personal interviews with selected supervisory board or committee chairs from DAX-listed companies using developed hypotheses on the "Board of the Future." The interviews aimed to determine how supervisory board work needs to evolve to meet future requirements and expectations that we have of the board today. ECBE evaluated the conversations and presented them accordingly in the study. Selected quotes from interviewed supervisory and committee members support the summary statements.

Quantitative analysis – Descriptive evaluation of supervisory board data

ECBE has a database for supervisory board members of German listed companies that contains publicly available information on the composition and structure of the supervisory board, as well as the personal characteristics of the supervisory board members or shareholder representatives. For the analysis, supervisory board data was initially collected based on the composition and structure of the supervisory board (supervisory and personnel panel) as of January 1, 2022, before the 2022

annual general meeting. Moreover, it is supplemented by the respective publicly disclosed changes after the annual general meeting and was then descriptively evaluated. If companies did not publicly disclose changes made at the annual general meeting, the database before the annual general meeting was used. If data on certain characteristics of supervisory board members were not available, these characteristics were not considered in the analysis.

Qualitative analysis – Experience from conducted evaluations

The insights from personal interviews and descriptive analysis were additionally classified with the help of ECBE's experience from conducted evaluations or self-assessments of supervisory board members.

Quantitative analysis – Empirical findings from academic journals

Using a literature review of empirical research papers, the essential insights of the study were supported by selected current empirical results. Only internationally recognized academic journals were considered in the review (see the VHB-JOURQUAL3 ranking for details).

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