

# On the 2023 nomination committee agenda

KPMG Board Leadership Centre

Business leaders are predicting and preparing for an imminent recession. Many are making hard choices now to help their businesses face volatile conditions, some are cutting back on important areas such as investing in their workforce and making their business more sustainable. Business recovery, growth, ESG commitments and the long term affects of the pandemic are likely to continue to test the skills and experience of board members. Has the board taken the opportunity to review and potentially reshape board composition to support new strategic imperatives, review succession planning, and created an environment for fairness, equality and opportunity allowing talented people to succeed? We highlight eight issues for nomination committees to keep in mind as they consider and carry out their 2023 agendas.

## 1. SKILLSETS TO EXPAND AND ENHANCE ESG OVERSIGHT

Environmental, Social and Governance (ESG) has gained significant momentum for businesses, investors and shareholders across all sectors. Our recent 2022 CEO Outlook found that 84% of UK CEOs see stakeholder demand for increased transparency on ESG issues and 67% believe that stakeholder scrutiny on issues such as gender equality and climate impacts, will continue to accelerate. It's no surprise then that a recent 'Sustainability Report' from Egon Zehnder found that of the world's largest 100 publicly listed companies, those with an ESG committee had increased from 54% in 2019 to 80% this year.

Climate change is front and centre and social factors have gained greater attention over the past year as changes in working and living practices due to the pandemic continue to change, and the cost of living crisis highlights social issues that were already there.

Oversight of ESG related risks – and equally importantly, the opportunities – starts with an ESG competent board. Not every board member needs to have deep-dive ESG expertise, but the board, as a whole, needs to have ESG risk and its impact on long-term value creation, top of mind. They need to understand which issues are of greatest risk or strategic significance to the company, how they are embedded into the company's core business activities, and whether there is strong executive leadership behind the company's response to the climate crisis.

Oversight of these risks and opportunities is a significant challenge, involving the full board and potentially multiple board committees.

For example, elements of climate, ESG, and DEI oversight likely reside with the audit and remuneration committees – and other committees, like an ESG or sustainability committee, may have responsibilities as well. Overlap is to be expected, so information sharing and communication and coordination among committees is vital, along with the expertise to oversee the issues delegated to them.

How is the nomination committee ensuring the board has the right skills and governance structures? Is this addressed as part of the annual board evaluation exercise? Do the companies' succession plans explicitly address ESG competency?

## 2. QUICKEN THE PACE ON VISIBLE AND INVISIBLE DIVERSITY

Core to the nomination committee role is ensuring that the board has the right combination of skills, backgrounds, experiences, and perspectives to probe and challenge management's strategic assumptions and to support management in navigating the company through an increasingly volatile and fast-paced global environment.

In their recent Review of Corporate Governance Reporting the FRC found that the majority of companies they assessed met or are on track to meet external diversity targets. However, this progress has yet to translate into senior roles, for example, CEO and CFO roles where progress appears slow. They highlight that policies should include objectives and targets (beyond the recommended external targets), and link to company strategy with actions taken to implement the policy and progress on achieving objectives.

Thanks to ongoing initiatives like the FTSE Women Leaders Review – there has been great progress in terms of women on boards. However, progress in other areas is still required to take a more holistic and intersectional approach to equality including women in executive positions, sexual orientation, disability and geographical heritage, as well as 'invisible diversity' traits such as socio-economic background and cognitive diversity. Diversity of international experience is also important for businesses operating across many different markets.

Consider the strengths that 'invisible' diversity traits such as socio-economic backgrounds and cognitive diversity of board members, could bring into board discussions. Findings from our recent survey 'Uncovering social mobility in the boardroom' show that only 15% of board members come from lower socio-economic backgrounds compared to 70% from professional backgrounds, and the FRC's Board Diversity and Effectiveness in FT350 Companies

report found that individual differences (personal/neuro/personality) are seen by directors as the most significant and important source of diversity in the boardroom – yet cognitive diversity appears to be an area that at present is both understudied and under tested.

Does the nomination committee use personality testing or cognitive profiling to assess whether the board has a mix of personalities and decision making styles that best contribute to effective oversight and decision making?

Expect continued legislative and regulatory action on board composition and diversity as evidenced by recent changes to the Listing Rules requiring issuers to include a statement in their annual report setting out whether they have met specific board diversity targets, and the recent announcement from the EU establishing mandatory quotas to ensure women have at least 40% of board seats, are likely in part, to increase the pressure to quicken the pace of change.

Also, be cognizant of the increased level of investor engagement – perhaps highlighting investor frustration over the relatively slow pace of change in boardrooms, and pointing to the central challenge with board composition: a changing business and risk landscape. Addressing competitive threats and business model disruption, technological innovation and digital changes, climate and ESG risks, cyber risk, and global volatility requires a proactive approach to board-building and board diversity – of skills, experience, thinking, gender, and race/ethnicity, etc. – is central to that.

Lastly, think about the breadth of the talent pool from which new board members are sought. Has sufficient attention has been given to recruiting directors with backgrounds in the third sector, academia and government, as well as entrepreneurs and those from family businesses? Challenge recruitment firms to provide a more diverse list of candidates and be specific about the skills and attributes required.

## 3. MOVE THE DIAL ON RACE

There has been some progress on minority ethnic representation on boards. The Parker Review reported that 94 FTSE 100 companies had, or would shortly have, minority ethnic representation on their boards, compared to 74 in November 2020. And FTSE 250 companies are making good progress towards the 2024 deadline with 128 companies having appointed at least one minority ethnic director as at December 2021.

Spencer Stuart's review of the Top 150 UK companies also suggests leap forward on ethnic diversity, with 15 percent of all board directors being from a minority-ethnic background, up from 11 per cent in 2021. The proportion of non-executives from minority ethnic backgrounds sitting on the board for the first time is 24% compared to 48% of all new NEDs.

- Is the nomination committee working with the board and CEO to demonstrate leadership from the top providing a clear strategy and roadmap? Employees should see the commitment to building the company's pipeline of diverse employees and board members, moving beyond symbolic gestures to bold interventions in both actions and conduct. Is the nomination committee seeing for itself what things are really like on the ground? Are they networking with people from ethnic minority backgrounds to understand the challenges and support any allyship, mentoring and development programmes.
- Is the nomination committee working with the board to set aggressive goals at all levels, including leadership and senior management, business unit heads, middle ranks, and internships? As with other KPIs, diversity metrics should be a matter of business performance and improvement in lived experiences, not a nice to have.

- Is the nomination committee sufficiently sceptical when told that lack of progress is due to a “lack of qualified candidates?” The phrase is often misused and an excuse for insufficient recruitment efforts. Understand the extent to which recruitment functions are connected to diverse communities and their ability to tap into a wide pool of diverse candidates; and present challenging targets to recruiters and or head-hunters.
- Tell the company’s diversity and inclusion story in detail. An honest picture of the company’s goals and progress towards achieving them is important in terms of credibility and confidence.
- The way boards communicate, engage and report on racial diversity will be critical going forward. Businesses that create frameworks that are transparent on the steps being taken to understand the issue within an organisation, deliver a plan and regularly report on the outcome will signal to employees and customers, their commitment to change and improve.

## 4. BOARD SKILLS REQUIRED TO SUPPORT GROWTH

Talent is a top operational priority for CEOs over the next three years alongside advancing digitisation and adapting to geopolitical issues. Whilst the pandemic may have highlighted skills sets required to deal with a crisis, the continuing priority is to ensure that talent, in the boardroom and in the pipeline, is retained and aligned to strategy – be clear on what the company’s strategy is, and where the skills gaps are in relation to that strategy.

Demand for experience in business transformation, recovery, technology and restructuring is likely to continue. Leadership styles have pivoted towards empathetic leadership and wellbeing issues, including a greater focus on women’s health, remain high on the agenda.

What steps is the nomination committee taking to ensure the board, leadership and senior management team are fit for purpose and well placed to support recovery and growth?

What development plans are in place to support both senior managers and those in the pipeline?

Advisory boards might be considered as a mechanism to fill any skills gaps and support the board in the execution of its duties. However clarity over their role, authority and place within the organisations governance framework will be key to success.

Equally, the use of third party advisors to support the board in areas where specific expertise is needed will likely continue, but regulators and investors are increasingly seeking greater transparency around who such advisors are and any affiliations, financial interests or ties that might bias their judgement and therefore impact their advice.

Digitalisation, robotics and AI are increasingly important components of many corporate strategies. Individuals with deep technological expertise can be hired at an executive level but board members still need to be able to ‘ask the right questions’ and just as important, ‘understand the answers’.

It is desirable to find individuals with specific skills who are also capable of contributing across the range of issues the board faces – not least because the board as a whole is responsible for all decisions, regardless of the expertise or knowledge of an individual director in that area – but have the risks around inexperience been overstated? And even if not, have they now been surpassed by the potentially higher risks associated with a board lacking in technology literacy?

Consider looking beyond the ‘usual suspects’ to find people with different experiences and backgrounds - including those who have not served on a listed company board before. Different leadership styles may unlock

organisational success, and with appropriate induction, mentoring and coaching, new directors should be able to adapt reasonably quickly.

Courage, integrity and the emotional intelligence to provide a balance of perspectives should not be underestimated as key requirements to help the CEO and organisation recover and support growth once again.

## 5. SUCCESSION PLANNING

The UK Corporate Governance Code puts diversity at the heart of good governance, requiring nomination committees to link their policies on diversity and inclusion firmly to their business strategy and to promote diversity in terms of new appointments and in their succession planning. However, many companies are providing very little information on how they have sought the right mix of skills and perspectives to drive their long-term success.

The FRC have reported that many companies simply note that the role of the nomination committee was to keep appointments under consideration. Detail on succession planning was scarce whilst many premium listed companies provide good detail on their appointment process (including the use of external recruitment agencies), very few articulate the deeper considerations around succession planning or the progression plans for those looking to move to board level

Similarly, the FRC have reported that many AGM notices relating to the re-election of directors simply cross-refer to the biographies included within the annual report and said nothing about how they contribute to the long-term success of the business. The more informative notices had detailed biographies and briefly explained why each director should be re-elected. The best clearly outlined the reasons for an individual’s re-election, specifically linking their contributions to company strategy and risks.

If recent times have taught us anything it is that having robust succession plans for times of stress as well as more benign times is critical.

Successors may be identified from 'rising stars' who have dealt with the impacts of the crisis and those that sit on multiple boards who can share insights from other organisations. The trend for boards to identify talented individuals to become 'board apprentices' to observe the boardroom and provide independent feedback, as well as gain valuable training to reach board level is increasing.

On a related note, nomination committees should, as far as possible, seek to preserve stability at the top of the organisation by avoiding appointing the Chair and CEO in quick succession. Similarly, nomination committees should, as far as possible, manage the retirement of board members so as to avoid losing too much 'corporate memory' in one go.

## 6. PLANNING FOR INCREASINGLY ACTIVE INVESTORS

In an environment where FTSE350 company directors face annual election, institutional investors are increasingly using targeted voting practices to register their displeasure at the board, voting against re-election of directors from the remuneration committee chair who displays an unwillingness to change executive pay arrangements to the audit committee chair who presides over a period of accounting irregularities.

ESG has now become a factor too with major investment houses going on record to say they would take voting action against directors at companies that were laggards based on their ESG scores and that could not articulate how they planned to improve their ESG metrics.

Furthermore, large institutional investors have for some years been using their voting powers to reduce the number of over-boarded directors on boards,

often through specific policy choices. The trend seems to be towards a recommendation of four or, at the very most, five mandates, with the board chair counting as three and committee chairs counting as two; and further reinforcement of the general principle that executives should have no more than one external role.

The nomination committee chair in particular should be wary of non-adherence to best practice, and can expect to be voted against if: the roles of the chief executive and chair have not been split; a senior independent director has not been appointed; the board has not conducted an externally facilitated evaluation of its effectiveness within the past three years; or an individual who has a significant conflict of interest, or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests is nominated (or re-nominated) to the board.

## 7. CHAIRING THE NOMINATION COMMITTEE

Compliance with the UK Corporate Governance Code (2018) prohibits the board chair from chairing either the audit or the remuneration committee though there is no such prohibition for nomination committees. Today, over 80% of FTSE 350 companies have their board chair also chair the nomination committee.

Whilst having the board chair as nomination committee chair has many benefits, for example visibility of the talent pipeline in the tiers below the board that are ready for development and succession planning, efficiency in communication between the nomination committee and the board, and only one leadership style to work with, there may also be a risk of undue influence which could compromise the independence of the nomination committee – for example, in shaping and hiring key directors. Carefully consider what is right for your organisation and whether the existing model needs revisiting.

All boards have a number of diverse personalities and getting the most out of them is what defines a great chair. A chair who understands the differences between board members and how they approach any given situation will be better placed to harness their skills and attributes and ensure that the board as a whole is greater than the sum of its parts.

## 8. THE VOICE OF THE WORKFORCE AND WIDER STAKEHOLDER PERSPECTIVES

Stakeholder perspectives are relevant for all board appointments and should be considered as part of succession planning and throughout the selection process.

Given the significant influence that a company's key stakeholders have on an organisation's prospects and licence to operate, the board's knowledge and understanding of the interests of those stakeholders is vital.

In order to engage effectively with the workforce, the UK Corporate Governance Code recommends one or a combination of:

- a director appointed from the workforce;
- a formal workforce advisory panel; or
- a designated non-executive director, or explain why an alternative arrangement is considered by the board to be effective.

What is the nomination committee's role in appointing a non-executive with designated responsibility for getting the voice of the workforce into the boardroom? Is there a formal process? Are specific characteristics and skill sets sought? Has consideration been given to tenure and rotation issues? Is more than one designated non-executive director necessary if the company has a large geographical footprint

For many, workforce directors still sit uncomfortably with the traditional UK Corporate Governance framework and are rare within the FTSE350. Nevertheless, they can provide tangible benefits to companies – particularly at a time when talent development strategies are being adjusted to meet the challenge of finding, developing, and retaining talent amid a labour-constrained market. Does the decision to not have a workforce director need revisiting? What can be learned from those who have appointed workforce directors?

Find out why Capita Plc decided to appoint employee non- executive directors - read the summary of our meeting with Capita Plc chair, Sir Ian Powell.

*This document has been created as part of KPMG's global Board Leadership Centre Program network. While it makes some reference to foreign regulation, it highlights the commonality of issues facing directors around the globe.*

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