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LEARNING FROM THE BEST SUPERVISORY BOARDS

RECIPES FOR SUCCESS BY BOARD CHAIRS OF GERMAN DAX COMPANIES

By Carsten Kratz, Alexander Roos, Ulrich Pidun, and Sebastian Stange

How can a supervisory board move beyond merely fulfilling its standard legal obligations and create value for the company? What do good supervisory board chairs do? How do they lead? The German Corporate Governance Code includes numerous formal rules for oversight and control. But it says nothing about the specifics and practicalities of supervisory board work; there is no textbook or how-to manual.

We spoke with more than 20 successful supervisory board chairs at major German companies about their experiences, their strategies, their methods, and their personal recipes for success. In the article that follows, we provide a brief summary of our conversations.[1]

The results are remarkable: Although the board chairs we consulted agreed broadly on the key success factors of good supervisory board work, their approaches to achieving success were as individual as their personalities. There is no blueprint that a supervisory board can use to create value, but our conversations present an opportunity to learn from the best.

Six Key Success Factors

In the course of our conversations, supervisory board chairs repeatedly cited six factors as being crucial to a board's success.

Fresh Views vs. Internal Insight: Assembling the Supervisory Board

A supervisory board needs members who have different competencies. All of the supervisory board chairs with whom we spoke agreed that the board's composition must be diverse if the board is to function effectively. But how do you find candidates who possess the required qualifications?

Different motivations lead to different approaches: Some supervisory board chairs use the traditional approach of tapping their personal networks in order to ensure working relationships based on trust. "When I choose my fellow board members myself and know them personally, I can rely on them to play an active and constructive role," explained one chair. Others take a systematic approach, enlisting outside consultants to identify the best candidates. Some consider the belief that a committee can recruit the right people from its own networks to be "illusory"; as one of our interviewees said, "You just don't know enough people for that approach to work effectively."

There is no consensus on the question of whether it is wiser to recruit supervisory board members from within the company or outside it. This is true for the key role of supervisory board chair as well as for regular board members. Many of the people with whom we spoke believe that experience in the specific company's environment is essential, especially for the position of board chair. This role requires both a profound understanding of the business and a well-functioning network within the company. Starting from scratch on both counts would simply take an outsider too long. According to one board member, "The longer someone's tenure on the committee, the more they can contribute."

Others, however, see an unbiased outside perspective as being especially valuable. Boards require "fresh blood" when entrenched views require critical scrutiny, they say. Supervisory board members drawn from outside the company provide an appropriate counterweight, since the position requires management experience and strategic foresight rather than operative expertise.

Every Contribution Counts: Getting Supervisory Board Members Involved

The extraordinary expertise that supervisory boards possess can be tapped only when all board members are on top of things and are actively involved. As the topics that boards must oversee grow broader and more complex, it becomes impossible to concentrate tasks in one or a few of the board's members.

Board chairs use different methods to get their colleagues involved. Some explicitly discuss specific roles with each board member in order to ensure that the board systematically covers all perspectives. One told us, "Every board member has to make a tangible contribution. If members fail to engage when we touch their area of expertise, I approach them proactively after the meeting."

One essential way to distribute growing workloads on multiple shoulders is by forming committees. Involving every board member in at least one committee can also increase members' contribution. One person whom we interviewed offered a concrete recommendation for triggering productive discourse: "Don't let the board chair lead any committee! You won't get a diversity of opinions [...]; a chair can hardly challenge his or her own position."

Committee work should focus on preparing for the full board discussions. "The board shouldn't repeat the discussion that already took place in the committee," said another interviewed board chair. Rather than present solutions, committees should explain the path to such solutions in a structured way, defining criteria and assessing available options.

Contrary to the general notion that employee representatives on the supervisory boards are a potential source of conflict that needs to be managed, many of the chairs with whom we spoke emphasized their positive contributions. Employees' insider knowledge and understanding of possible risks can improve control. Critical employee-related issues can often be addressed and resolved earlier and thus more quickly. "They should be seen as an opportunity, not a problem," said one interviewee. "You should use their insight systematically and wisely."

From that perspective, it is smart to include employee representatives on innovation committees, for instance, to involve them early in required change. One of our chairs goes even further and conducts long-term succession planning for employee representatives: "I talk to them very early about succession. Then we support potential candidates with targeted training and ensure that they get relevant experience within the company." Although the workers' side ultimately elects employee representatives, this approach can strengthen the competence profile of the supervisory board's employee members in the long term.

Benefiting from Diverse Opinions: Constructive Board Discussions

Our interviewees agreed that the chair is responsible for ensuring open and results-oriented board discussions. But the specific style of the chair, ranging from directive leadership to participative moderation, often depends on the immediate situation and the individual's personality. As one interviewee reported, "I actively encourage people to express divergent opinions, which is usually not done on traditional supervisory boards." For many of our chairs, striking the right balance is key. Sometimes it may be necessary, they say, to discuss critical topics beforehand or to curtail attention seekers and fruitless discussions.

Agenda setting is particularly important, our chairs emphasize, because it ensures that the board addresses important or controversial topics and has sufficient time for discussion. Defining the agenda should not be left to management alone. The supervisory board should have a say in determining which questions are discussed and at what length.

Finally, to ensure well-informed debate, the supervisory board must have access to all available information about the topic at hand, including access to external sources of information. Unfortunately, not all boards receive analyst reports, press reviews, and market studies, for example, from the companies they are overseeing.

At Arm's Length or Up Close: Exercising Effective Control

Our chairs agree that recognizing and preventing significant errors within the company are core responsibilities of a supervisory board. "I believe the most important task of the supervisory board is to cover the blind spots. Risks and opportunities are more visible from the outside," one said. Supervisory board chairs with whom we spoke described various practical approaches designed to ensure effective control. (See also *Looking for Smoke Under the Door: The Case for an Actively Engaged Board*, BCG report, August 2016.)

Strictly adhering to legal compliance is, of course, foundational. Such adherence does not "create value per se, but it prevents potential massive value destruction," one board chair observes. Consequently, most of the chairs we interviewed advocate a zero-tolerance policy. Nearly all supervisory boards have established predefined processes for crisis situations—for example, having an activist defense manual in place.

This does not translate into strict avoidance of risk, but rather into "well-founded risk-taking." For this reason, one of our chairs introduced a regular "Risk and Opportunity Report." But simple reporting cannot replace open, transparent communication by the company's management. A good working relationship with management is therefore essential, according to the board chairs with whom we spoke. Striking the right balance between being critical and collaborating in a trustful way is clearly an art.

The question of whether it is preferable to exert control before decisions are taken or afterward brought a mixed response. Some supervisory board chairs said that their involvement begins early. They insist on receiving and reading the documents from management board meetings, have access to the company's management information system, and cultivate a constant exchange with managers below board level. "Accompanying key initiatives and decisions can make anticipatory control possible" a chair said in describing his approach.

Other chairs believe that, as one said, "distance is necessary, so management can be measured by its own statements and ambitions." One board member explained, "I am strongly disposed to place high trust in the management board." In his view, the supervisory board should "ensure long-term strategic viability" by "evaluating strategic position" and "participating in the setting of strategic targets," while limiting itself to an after-the-fact review of financial results. Such oversight may include requesting regular progress reports on big investments and other major decisions.

Preparing Well in Advance: Appointing the Management Team

Appointing the members of the management team is one of the supervisory board's main responsibilities. But the ways in which different boards handle this responsibility could not be more diverse.

Many supervisory boards conduct active succession planning. Irrespective of ongoing appointment requirements, they request reports on the development of junior managers periodically and "keep a list of top talent." They also ensure that managers below board level have regular opportunities to make presentations to the supervisory board. They attend top management meetings, or use time before or after supervisory board meetings to get to know managers better over lunch or dinner. Some supervisory board chairs even add "half a day to the agenda to discuss the first-tier management level." Several of them emphasized that they find it helpful to get the "perspective of the employees' representatives, even though it may be politically colored at times." Many chairs see a trend toward increased contact between the supervisory board and company management.

Others view control as being the primary job of the supervisory board. "You can't really get to know a manager" from presentations made to the supervisory board, they say. Responsibilities are clearly defined: succession planning lies in the hands of the management team, while hiring decisions are the job of the supervisory board's personnel committee. "The board's aspiration to be involved in the hiring process must fail," says one. "The identity of candidates, especially those who don't get the job, must remain confidential to protect them."

Continuous Improvement: Developing the Supervisory Board

How can the work of the supervisory board be improved? All of our discussion partners say that they find the annual effectiveness review (as recommended by the German Corporate Governance Code) and regular systematic discussions to be very helpful.

Reviews can differ greatly in method and depth, however. Sometimes, external experts support the process. In other instances, supervisory boards prefer to perform such reviews on their own. One of our chairs reported that he conducts "individual feedback talks with each member of the supervisory board."

Elsewhere, members of the supervisory board conduct peer reviews of one another. One chair commented: "I found it strange at first, but it has actually been very helpful."

Two of our chairs report that they "consistently replace members [...] who do not contribute." Others use expiring mandates as opportunities to bring in new, previously missing competencies. "But overall, this still doesn't happen enough," one says.

Find Your Own Way

Good corporate governance lays an important foundation for business success. In the past 20 years, corporate governance at most large German companies has come a long way, and the benefits of this development are clear. The success factors for effective supervisory board work are widely understood today, but how to implement them is less obvious. Our conversations with supervisory board chairs at leading, internationally active companies revealed various personal recipes for success that can help other supervisory boards find their own best way.

Note

1. Some findings apply only to the German two-tiered supervisory board, which is separate from management and, in the case of large companies, may include workers' representatives.

Carsten Kratz is a senior partner in the Frankfurt office of The Boston Consulting Group and is managing director for Germany and Austria. He can be reached at kratz.carsten@bcg.com.

Alexander Roos is a senior partner in the firm's Berlin office, a BCG corporate development expert, and leader of BCG's corporate governance topic in Germany. He can be reached at roos.alexander@bcg.com.

Ulrich Pidun is a director in BCG's Frankfurt office and a BCG global expert on corporate strategy and corporate governance. He can be reached at pidun.ulrich@bcg.com.

Sebastian Stange is a global expert principal for corporate strategy and corporate governance in the firm's Munich office. He can be reached at stange.sebastian@bcg.com.

Acknowledgments

We would like to thank all of the participants for the open and interesting conversations we had with them.

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