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Board Structure and Composition

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Balancing workload and responsibilities of the board and its committees

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Introduction

It may be time for US public company boards to take a fresh, disciplined, and in-depth look at their committee structure. This would involve more than the standard annual review of committee charters in light of evolving regulatory requirements, investor expectations, and proxy advisory firm policies. Instead, it would be a thorough and company-specific evaluation of how committees can best support the board in fulfilling its *multiple* roles in guiding the corporation.

Since November 2004, the major US stock exchanges have required listed companies to have three standing committees composed exclusively of independent directors: audit, compensation, and nominating.[1] That requirement continues to have a profound impact on the committee structure at US public companies. Twenty years later, nearly 100% of S&P 500 companies have audit, compensation, and nominating committees.[2]

Yet, most major public companies are evidently finding these three committees alone inadequate for their needs. As of mid-2023, 74% of the S&P 500 had more than three board committees: 36% had four, 21% had five, and 13% had six.[3] Along with executive, finance, and risk committees (also required by regulation for certain large financial institutions),[4] boards have established committees focused on public policy, science and technology, and sustainability, among other areas.[5]

In addition to establishing new committees, boards are expanding the remit of the three core committees. For example, nearly half of S&P 500 companies have expanded the role of their compensation committees to cover topics relating to human capital management,[6] a comparable percentage has assigned general oversight of environmental, social, and governance (ESG)/sustainability to their nominating committee,[7] and companies have long been adding responsibility for areas such as cybersecurity to the laundry list of audit committee duties.

Something is going on here. It is, I would suggest, more than just boards' desire to respond to the governance topic *du jour*. Rather, it reflects a widening gap between today's imperative that the board and its committees serve as *strategic thought partners* with management in guiding the direction of the corporation, and the more limited role of the board and committees codified in the stock exchange listing standards adopted over 2 decades ago, which focused on the board's responsibility for *independent oversight of management*. If this hypothesis is correct, then boards should do more than make *ad hoc* adjustments to their committee structure and should instead undertake a more comprehensive review.

This article explores why it is worth revisiting the traditional committee structure and provides a roadmap for companies to conduct a thorough review of their committee structure, taking into account how board committees can add value in helping the board fulfill its potential.

Such company-specific board committee reviews may not—indeed, probably *will not*—result in a wholesale revision of a board's committee structure. After all, boards will still need to comply with laws, regulations, and listing standards that focus on three or four committees. And there are only so many committees a board can reasonably populate and a management team can responsibly support. But a comprehensive review *can* give boards a clearer understanding on how their committee and board structures can (and should) evolve in tandem over time to serve the corporation's best interest.

A (mis)match made in crisis

From the very outset, there has been a mismatch between many of the rules governing board and committees, on the one hand, and their actual roles and responsibilities, on the other.

Professors Jay Lorsch and Colin Carter neatly outlined the three core responsibilities of boards in the classic governance text from 2003, "*Back to the Drawing Board: Designing Corporate Boards for a Complex World*: Boards *decide, oversee, and advise*." Today, board members also frequently *engage* directly with investors and sometimes other stakeholders.[8]

Even as *Back to the Drawing Board* was hitting the shelves, the US stock exchanges, under the auspices of the Securities and Exchange Commission (SEC), were developing corporate governance listing standards, approved by the SEC in November 2004, that focused very heavily on just *one* of those areas of board responsibility: independent oversight of management. Even then, the listing standards did not focus on oversight in general, but rather on specific areas, particularly relating to financial reporting, disclosure, and risk management.[9]

The listing standards' limited focus is understandable

The standards were, of course, adopted in the wake of the collapse of Enron and WorldCom. As policymakers reviewed the boards' roles in those catastrophic corporate failures, they repeatedly focused on the board's lack of independent oversight of management in a few key areas. For example, the key Senate Subcommittee report on The Role of the Board of Directors in Enron's Collapse made recommendations that fell under just two headings: “strengthening oversight” and “strengthening independence.”[10]

And it was undoubtedly easier (and wiser) for policymakers to focus attention on a board’s oversight role in areas such as finance and risk, rather than on the board’s role in making decisions on the company’s business, which is inherently more dependent on a company’s individual circumstances. Indeed, while policymakers also cited Enron’s “asset light” *strategy* as contributing to its bankruptcy, they did not attempt to dictate what the board’s role should have been with respect to setting strategy.[11]

Yet, this emphasis on independent oversight in a few (albeit important) areas left some big gaps. For example, while the NYSE listing standards require companies to have corporate governance guidelines that address the full board, they do *not* require those guidelines to define the collective role or responsibilities of the board; rather, they focus on the qualifications, responsibilities, and access to information to enable *individual* directors to perform their role.[12] Nowhere do the listing standards address the board’s or committees’ roles—in either a decision-making *or* oversight role—in strategy, operating or capital plans, budget,[13] capital allocation, or in key areas such as the company’s technology, workforce, facilities, public policy, and so on.

Over time, some companies have tacked these missing areas onto existing committees—even when they may not particularly fit or when it may result in overburdening the committee. For example, many boards have given responsibility for substantively overseeing the company’s sustainability (ESG) efforts to the nominating committee, even when those committees may not have the background to oversee the development and integration of environmental and social responsibility in the company’s business.[14] And audit committees have been described as becoming the “kitchen sink” of the board, where areas that do not squarely fit within the scope of the audit committee, but which have some link to financials, risk, and disclosure (does not everything?) find their home.[15]

Even with this accretion, gaps remain

And these gaps can have serious negative consequences. A series of Delaware court decisions have faulted boards for failing to have committees responsible for overseeing “mission critical” areas of the company’s business, whether aircraft safety at Boeing[16] or food safety at Blue Bell Creameries.

Beyond the harms that can come with a committee structure that does not align with the company’s business needs, there can also be lost opportunities. What acquisitions may not have been pursued, products not developed, efficiencies achieved, talent developed, or public policy goals advanced because of a lack of committee engagement? One might argue that the decision-making responsibility for most if not all of these business areas falls more properly under management rather than the board or a board committee. Fair enough. But as former Harvard Law School Dean Robert Clark observed 2 decades ago, boards and committees nonetheless play an invaluable if subtle role:

The mere fact that the top executives know they have to make formal presentations about key issues on a regular basis to an audience that may probe and criticize, and that has formal power to remove them, elicits a great deal of valuable behavior.

Facts are gathered more carefully and completely, ideas and judgments are made more explicit, competing considerations are anticipated and dealt with, and modes of articulation that can withstand scrutiny outside the inner circle are found. The consequence of all these efforts to better "explain and sell" the executive viewpoint may well be to clarify strategic thinking and improve decision making.[17]

So, for all these reasons—the fundamental mismatch between the roles of the board and the required committee structure, the resulting gaps that can cause losses (and lost opportunities), and the sub-optimal attempts to fill those gaps—it is at least arguably worth boards taking a fresh and comprehensive look at their committee structures.

The real-world benefits and costs of board committees

The following is a suggested five-step process that companies can undertake to conduct a thorough review of the board's committee structure.

As a threshold matter, the process is probably best led by the corporate secretary or general counsel, enlisting the input from other key executives, including the chief executive officer (CEO) and others with responsibility for areas that are reported to (or should be reported to) the board and its committees. The project should be conducted under the auspices, and with the active engagement, of the nominating committee. While a lot of the groundwork in assessing committee structure can be done by management, there should be no doubt that the nominating committee is in charge of this project, answerable only to the board. As a legal matter, it is up to the board to decide its committee structure. And as a practical matter, management alone may be hesitant to recommend additional responsibilities for board committees (or even the creation of new committees) that could mean more scrutiny and work for management. Having the nominating committee, especially its chair, play an active role in this process can help to ensure that management thinks more broadly about how committees can provide incremental value.

Step one: conduct an inventory of existing board and committee responsibilities

The first step is to develop an inventory of the current responsibilities of the board *and* its committees, whether those are formally reflected in the by-laws, governance policy, and committee charters, or are simply a matter of practice. While the focus is on *committee* responsibilities, it is important not to look at them in isolation, but instead understand how committee responsibilities lead up to the full board and, conversely, how the full board's responsibilities are informed by the committees.

As you create the inventory, it can be helpful to note what type of role the board and committees are playing (decision-making, oversight, advisory); whether the role is clearly defined (for example, the term "review" can be an ambiguous and suggest either approval *or* oversight); and whether the item reflects a regulatory requirement.

Step two: consider how board and its committees add value

Now, set aside the wonderful inventory you have created and take a moment to think bigger. Consider how the board and committees can add value in light of your company's particular circumstances.

To frame this discussion, it may be helpful to being by thinking about the company's strategy. After all, strategy is where boards want to, and often can, add the most value. Consider how the company's business strategy is carried out in three broad arenas: (i) the marketplace (i.e. the products and services the firm sells, and those it buys); (ii) the workspace (i.e. its operations and workforce); and (iii) the public space (e.g. its disclosures and other communications, governmental affairs, corporate social responsibility).

Then consider how board and its *committees* could contribute in those three strategic arenas. In concept, there are at least four ways committees can deliver value:

- **Pre-board review:** first, committees can improve the effectiveness and efficiency of the full board by providing an opportunity for a subset of directors to delve more deeply into a topic before it is presented to the full board for consideration. This is a function served today by audit committees, which review financial statements before they are presented to the full board, as well as by nominating committees that typically review governance documents before board approval. But there are other areas where boards are finding it helpful to have a committee—either on a permanent or temporary basis—review matters first, such as in the areas of strategy, finance, sustainability, and technology. By contrast, an executive committee that simply serves as dress rehearsals for board meetings may not add that much value.
- **Heightened oversight:** a second and related way committees can add value is by providing a heightened degree of oversight of management in certain areas. This is a common function of audit and risk committees. However, it may also be appropriate in other areas where the company's management is facing particular challenges (e.g. product or employee safety) or future opportunities (e.g. post-merger integration), and where a greater degree of board-level attention can be beneficial.
- **Independent decision-making**: a third useful function of committees is to provide a forum for making decisions that are not only independent of management, *but also (at least to some extent) from the full board*. For example, this is a common function of compensation committees, which (rather than the full board) approve executive compensation. And, of course, it is true of special litigation committees and similar committees that are established to review legal claims implicating fellow board members.
- **Forging a consensus:** there are also situations where committees do more than just provide a conventional pre-review of items that go to the board. Here, the role of committees is even more meaningful than improving the efficiency of board meetings; it is to drive consensus. This can occur when there is disagreement on the board, the need to handle a particularly sensitive topic, or a desire for greater coordination among board committees. These functions can be served by an executive committee that brings together committee chairs and other board leaders. Or they can be served often by temporary committees, for example, to build consensus on company strategy, to oversee CEO succession, or to determine how to allocate responsibility that may fall under multiple committees.

To visualize this analysis, you can think of filling in the following chart:

Area of business activity/role of committee	Marketplace	Workplace	Public space
Pre-board review			
Heightened oversight			
Independent decision-making			
Forging consensus			

So, under the heading of the company's marketplace activities, would it help to have a committee review the company's product strategy before it goes to the board? Could a committee usefully provide heightened oversight over product innovation or the supply chain resilience?

Under the heading of the workplace, would it make sense to have a committee to provide heightened oversight of operations in general, or some subset such as technology?

When it comes to the company's activities in the public space, would it be helpful to have a board committee take play an independent decision-making role in deciding whether to weigh in on social issues (thereby helping to protect management from constant pressure)?

Or, looking a look at a topic that cuts across a company's activities in the marketplace, workplace, and public space, would it help to have a committee forge a consensus, provide heightened oversight, and offer pre-board review of the company's sustainability strategy?

This process should result in a list of strategically important responsibilities that could be assigned to committees. This exercise can also be extended beyond core business strategy to other support areas such as finance, technology, and human capital.

Step three: conduct a gap analysis

The next step is to conduct a "gap analysis" comparing the current responsibilities (step one) with the list of potential committee responsibilities (step two).

As a result of this review, you might conclude that there are some new responsibilities that could be assigned to committees, or existing committee responsibilities that can be removed. Perhaps most importantly, however, you may identify additional ways in which the *full board*, and not just committees, can add value.

This process should result in a comprehensive list of desired committee responsibilities.

Step four: defining a desired committee structure

The next step is to figure out how to allocate current and new responsibilities among committees.

Clarity: as a threshold matter, it will be important to be very clear about the responsibilities themselves. Is it the committee's role to decide, review, oversee, or advise with respect to each responsibility?

Cohesion: next, ensure that each committee has a cohesive set of responsibilities, which is usually based on subject matter, but also could consider the stakeholders they focus on (e.g. employees, investors, regulators).

Number: consider how many committees you can responsibly populate. This will depend on the size of the board (including the number of eligible directors) and the size of committees. For example, a 10-member board could theoretically populate four committees with five people each, if each person served on two committees.

Timeframe: consider whether you need to have a standing committee, or if this should be a temporary committee that has a defined goal, or if it is something in between. There is no shame (or harm) in having a dynamic set of committees that evolve in response to a board's changing circumstances.

Composition: evaluate whether you have the right set of directors to populate committees. There may be no need to seek "expertise" on most committees, other than on the audit committee; fluency and the willingness to learn may be enough, as long as the committee can draw on expertise from inside and outside sources. Similarly, unless required by regulation, you may also want to consider whether you want only independent directors on a particular committee.

Workload: assess whether the workloads are appropriately balanced among the committees and among individual directors. While it is important to consider workload, it should probably take a backseat to cohesion and capabilities. For example, nominating committees have often given responsibility for ESG, in part because they already have responsibility for "G" in their remit and because they may be perceived as having more time than the compensation or audit committees. But does the nominating committee actually have the composition to add value in overseeing the company's environmental strategy as carried out in the marketplace, workplace, and public space?

Resources: do you have the sufficient internal and external resources to support the committees?

Stakeholder perspectives: finally, it can be helpful to consider how your new committee structure would not only satisfy any regulatory requirements, but also be viewed by your major institutional investors, proxy advisor firms, and other influential stakeholders.

Step five: defining and implementing plan to get there

The foregoing analysis should give you a schematic with the number, name, responsibilities, and desired composition for each committee.

It may not be possible to get to a desired committee structure off the bat. You may need more directors—or different directors—which may require time as vacancies occur on your board and committees. You may need additional internal or external resources to support the new committee structure. And the board may have an appetite only for incremental change.

But once the board endorses an approach, management should develop a plan to achieve it and to track progress over time. It also can be helpful to communicate your plan within the management team (even beyond the executives involved in the project) and, at the appropriate time, with your investors, who may be keenly interested in (and delighted by) your careful analysis of how your committees can best add value in advancing the company's strategy.

Conclusion

Taking a fresh and rigorous look at a company's committee structure can do much more than simply result in the renaming of committees or reorganizing responsibilities. It can lead to a deeper understanding and consensus regarding the roles of the board, committees, and management—and the relationship among the three. It can help to identify gaps in board and committee oversight; in board, committee, and management capabilities; and even in the company's underlying strategy. So even if the exercise results in few, if any, changes in the committee roster or committee charters, it can have significant salutary benefits.

Chapter notes

1 Securities and Exchange Commission, NASD and NYSE Rulemaking: Relating to Governance, Release 34-48745 (November 4, 2003) https://www.sec.gov/files/rules/sro/34-48745.htm. While regulations and listing standards refer to nominating/ corporate governance committees, this article refers to them by shorthand as "nominating" committees. Boards may allocate the responsibilities of the nominating and compensation committees to other committees, as long as those committees are composed exclusively of independent directors; they may not do so with audit committees. Compare, for example, commentary to NYSE Listing Standard 303A.04–05 ((nominating and compensation committees) with 303A.07 (audit committees).

2 Board Practices and Composition 2024 Edition, A. Jones, M. Spierings, and P. Hodgson, The Conference Board (2024).

3 Board Leadership and Structure: Spotlight on Flexibility and Transparency, M. Spierings, The Conference Board (2023).

4 12 USC Section 5365 (2023); 12 CFR Section 252.22. (2019).

5 Id.

6 The Compensation Committee's Evolving Role in Human Capital Management, B. Jones, J. Teefey, Rachel Kai, Harvard Law School Forum on Corporate Governance (2023) (Link: https://corpgov.law.harvard.edu/2023/10/31/the-compensation-committees-evolving-role-in-human-capital-management/).

7 Board Leadership and Structure: Spotlight on Flexibility and Transparency, The Conference Board M. Spierings, (2023).

8 ESG Is Changing Boards. Investors Should Look Closely, P. Washington, Barron's (2023) (noting over half of S&P firms report that their board members directly engage with shareholders).

9 See, generally, NYSE, Section 303A.07 (2013) (describing the role of the audit committee). (Link: https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074b).

10 The Role of the Board of Directors in Enron's Collapse, Committee on Governmental Affairs Permanent Subcommittee on Investigations (2002) (Link: https://www.hsgac.senate.gov/wp-content/uploads/imo/media/doc/REPORT%20-%20Role%20of%20Board%20of%20Directors%20In%20Enron's%20Collapse%20(July%202002).pdf.

11 Id.

12 NYSE, 303A.09.

13 Other than the internal audit function budget under NYSE Section 303A.07 (2013).

14 Board Leadership and Structure: Spotlight on Flexibility and Transparency, M. Spierings, The Conference Board (2023).

15 The Audit Committee: The Kitchen Sink of the Board, L. Cunningham et al., Center for Audit Quality (2022) (Link: https://thecaqprod.wpengine.com/

wp-content/uploads/2022/11/caq_ac-kitchen-sink-of-the-board_2022-11.pdf).

16 In Re The Boeing Company Derivative Litigation, Del. Ch. (2021) (Link: https://courts.delaware.gov/Opinions/Download.aspx?id=324120).

17 Corporate Governance Changes in the Wak of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too, R. Clark (2005) (Link: http://www.law.harvard.edu/programs/olin_center/papers/pdf/Clark_525.pdf).