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Directors' duties in today's world: what really matters

By Andrew Gray

Board leadership of complex organizations is always challenging. Setting strategy, engaging with stakeholders, supervising management and overseeing operational and legal risks are all highly demanding responsibilities. Executing on those responsibilities amid change is especially challenging, and especially important. Good governance practices will help a company succeed financially, attract and protect investors, and will lead to a sustainable and resilient business. Amidst change around and within the business, focusing on what really matters is critical.

Governing in a changing world

Changes in business, the economy and society significantly affect what directors need to focus on, and the changing world poses challenges for directors that are very significant. Climate change, and commitments to adapt businesses to climate risk, is a high-stakes governance challenge. Directors face pressure from investors and from activists with or without large investments. Shareholder litigation and shareholder proposals seek to shift decision-making on an organization's climate policy from directors to shareholders. Environmental, social and governance (ESG) concerns more generally attract board attention, whatever the evolving nomenclature, despite ESG-related political pressure on businesses and their leaders. That can include everything from climate change, racial equity in the workplace, and enhanced disclosure relating to supply chain practices.

Artificial intelligence, including as it relates to board practices, is yet another major area of change and challenge. Directors have to consider the impact of AI in their own practices as well as the yet undetermined but inevitably very significant impact of AI on the operations of their organizations. Similarly, cybersecurity and data governance responsibilities add to the evolving nature of directors' duties—an expanding list of what matters to directors in today's world.

Governing a changing business

The directors of all organizations must adapt their practices to dramatic changes in the world in which they govern. Governance matters even more when the organization itself is going through a period of change.

Directors have a heavy burden to manage change generated internally and externally. Getting leadership succession right is a key responsibility, whether that is board renewal or planning for and executing on chief executive officer succession. When it goes wrong, and when stakeholders react negatively to the board's succession activities, can be highly disruptive. Shareholder activism is not diminishing; shareholders, focused on a range of issues, insist on having more than a passive role in setting the direction of the business, whether that relates to executive compensation, ESG or transactions. And the source of activism from within a company's shareholder base is broadening to include institutional investors. Current topics for this year's proxy season reflect the pressures shareholders are asserting, from the way they meet and vote and beyond, supported by third-party guidance and other ways shareholders can use and amplify their voice. When businesses face distress, a particularly salient risk in difficult economic circumstances, directors have to adapt their practices and listen to creditor stakeholders. The "zone of insolvency" acutely challenges the strength of a business's governance framework and culture.

Governance essentials

Governance essentials matter whether the business is a family-owned enterprise, with the unique issues arising in that context, or owned or controlled by private equity. Those are not the only kinds of ownership structure that test governance principles; the commercial success of the weight-loss drug, Ozempic, has attracted attention to the mainly European phenomenon of the foundation-owned firm—a not-for-profit owner of a for-profit business organization—which performs at least as good as rival ownership structures. Other forms of organization also depend on governance essentials for their success, including corporations formed as or committed to being benefit corporations, or non-business corporation forms such as charitable organizations or pension plans. For all organizations, the day-to-day application of governance essentials—such as consideration of director and officer liability, conducting investigations, setting executive compensation, and ensuring independent decision-making of special committees beyond mere formalities—continue to matter.

To be effective, boards need to focus on the right things—strategy, management supervision and risk oversight—and adopt the right processes. Directors should be well-informed, and in the context of a changing world, that means new kinds of expertise. A board may need climate, AI or data governance experts to serve as directors, and they may need advisors in those areas. They will certainly need education about those issues and company-specific ESG considerations. Directors also need to ensure decision-making is independent in substance and not merely in form. That will mean, among other things, considering the relationships between directors and management and directors and shareholders. Those relationships can be sources of fruitful contributions to board deliberations, but depending on the matter before the directors, they can also taint decisions with conflict. For public companies in particular, directors need to be thinking about how they inform investors—complying with evolving disclosure requirements—and how they engage with them beyond shareholder meeting season.

Even in a changing world, or for an organization facing its own changes, the role of directors is, of course, always to guard and promote the company's best interests while hearing, weighing and balancing stakeholder voices. Strong governance practices and a strong governance culture are essential for business success and for the positive economic and social contributions businesses make.