Guest editor

Mirko Benischke

Contributing authors

Siah Hwee Ang
Alessia Falsarone
Trevor Hunter
Hirindu Kawshala
David F. Larcker
Filip Lestan
Ruy de Quadros Carvalho
Amit Seru
Brian Tayan
Shuhui Wang
Laurie Yoler

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Anticipate, Innovate, Transform

Corporate Boards:

Navigating Decision-Making & Priorities in Complex Times

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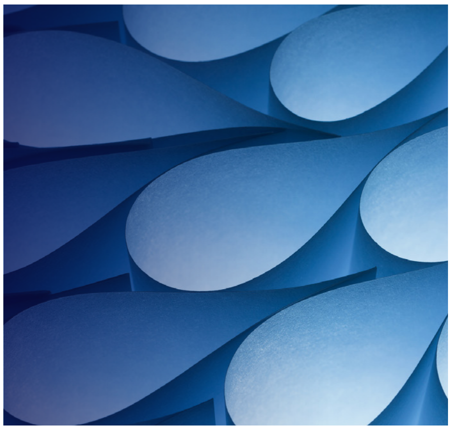

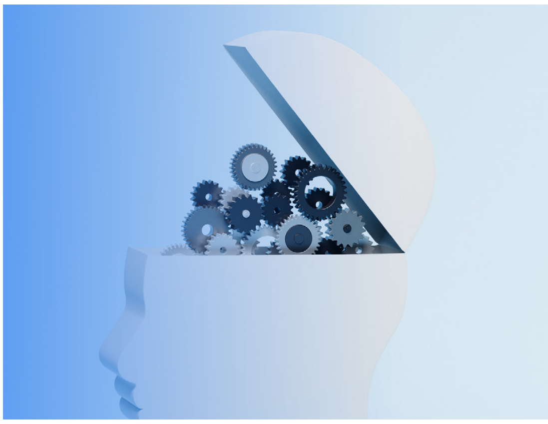

CORPORATE BOARDS: NAVIGATING DECISION-MAKING & PRIORITIES IN COMPLEX TIMES

BY MIRKO BENISCHKE, GUEST EDITOR

The board of directors holds ultimate responsibility for the health of an organization. However, as noted by Ryan Krause and his colleagues, "There remains considerable ambiguity as to what constitutes effective board decision-making, and even greater ambiguity as to how to achieve it."[1] Many view the board's primary role as monitoring and advising. Increasingly, however, its real value lies in helping the executive team navigate today's complex business environment. This perspective emphasizes the importance of boards that provide strategic guidance to CEOs and their teams.

On closer examination, this idea may not align with our own definition of what drives sustainable competitive advantage. Board members are often far removed from the operational realities of the organizations they serve, and their advice leads to superior performance only if it is both rare and difficult to substitute. Moreover, CEOs and their teams have access to many other sources of strategic guidance — strategy consulting firms, for example. Of course, the board's advisory role is more nuanced, and the experience that board members bring to decision-making can indeed add significant value in the right circumstances.

Similarly, when we think of monitoring, high-profile cases like Enron or WorldCom often come to mind — situations where executives engaged in fraudulent activities. However, volumes of research show that "bad" decision-making more commonly stems from a simple truth: decisions are made by humans.[2,3] Even well-intentioned, highly skilled, and capable executives can make choices that, in hindsight, are seen as mistakes.

In their *Harvard Business Review* article, Andrew Campbell, Jo Whitehead, and Sydney Finkelstein pose a provocative question: "Why do good leaders make bad decisions?"[4] Their answer points to the influence of cognitive biases on human decision-making. For instance, hubris or overconfidence can lead to CEOs overestimating their own abilities — often based on a string of past successes driven more by luck than sound decision-making.

What does this mean for board decision-making? Monitoring is clearly important, but we believe boards should go beyond detecting fraud or misconduct to help establish processes that mitigate biased decision-making and elevate overall governance quality.

A significant step in that direction is for boards to prioritize asking in-depth questions over offering advice. This shift repositions the board from passive oversight to active participation in shaping the conditions for effective decision-making and long-term performance.

IN THIS ISSUE

This issue of *Amplify* features a collection of articles that explore how boards can evolve beyond conventional roles to become active stewards of long-term value — drawing on leader character, data and analytics, behavioral insight, structural design, and strategic engagement.

Trevor Hunter opens the issue by examining how leader character strengthens board decision-making. As environmental, social, and governance (ESG) considerations and the United Nations's (UN's) Principles for Responsible Investment (PRI) reshape board responsibilities, directors are now accountable to a broader set of stakeholders beyond shareholders. Hunter draws on the Leader Character Framework developed by Mary Crossan, Gerard Seijts, and Jeffrey Gandz of Canada's Ivey Business School, highlighting its role in navigating complex — and sometimes conflicting — obligations. Research shows that the framework's 11 dimensions, including courage and integrity, support ethical behavior and long-term success. These traits can be embedded in board policies and codes of conduct to signal a strong commitment to principled governance.

> **THE BOARD'S REAL VALUE LIES IN HELPING THE EXECUTIVE TEAM NAVIGATE TODAY'S COMPLEX BUSINESS ENVIRONMENT**

Next, David F. Larcker, Amit Seru, Brian Tayan, and Laurie Yoler explore how AI could reshape boardrooms by enhancing the volume, quality, and timeliness of information available to directors. AI can reduce information asymmetry, support predictive analysis, and enable real-time scenario planning. These tools help boards become more proactive and better prepared for meetings. However, the authors caution that greater access to information may blur the line between governance and operations, requiring executives to manage directors' deeper involvement carefully.

Shuhui Wang and Hirindu Kawshala then analyze more than 14,000 earnings call transcripts to examine how CEO overconfidence impacts firm complexity. They find that overconfident CEOs tend to reduce complexity, often at the cost of long-term alignment, as illustrated by John Flannery's short tenure at General Electric. Their study underscores the importance of aligning CEO traits with a firm's strategic and operational needs, particularly during leadership transitions. Boards must discern whether simplification efforts reflect sound strategy or risky overconfidence.

In her article, Alessia Falsarone examines the evolving role of lead independent directors (LIDs), offering a five-part framework to assess when and how to appoint them. Although LIDs can strengthen board independence and communication, their function varies by context. In firms where the CEO also chairs the board, LIDs often serve as a bridge to management and stakeholders. In other cases, they foster open dialogue on issues like ESG and AI ethics. Falsarone illustrates this with examples, including Coca-Cola's LID leading efforts in transparency and sustainability amid activist pressure.

Next, Filip Lestan and Ruy de Quadros Carvalho analyze 249 Brazilian firms to assess how board structure influences innovation governance. They found that forming innovation-related committees is far more impactful than vision statements or rhetoric, enabling boards to ask better questions and oversee complex initiatives. Larger boards are more likely to form such committees, while CEO duality and director busyness significantly reduce the likelihood. The article concludes with four actionable steps to strengthen innovation governance through board design.

Finally, Siah Hwee Ang closes the issue by calling for a shift in how executives engage with boards — not just as monitors or advisers but as long-term strategic assets. He advocates for structures that tap into directors' expertise through agenda setting, follow-ups, and subcommittees. Boards' hard skills can be institutionalized via staggered succession, while soft skills can be preserved by documenting decision-making processes. Regular engagement is key, with boards contributing to short-, medium-, and long-term strategic discussions.

RETHINKING BOARD EFFECTIVENESS

This issue of *Amplify* invites a reexamination of what makes boards truly effective — not merely as watchdogs or advisers, but as architects of sound decision-making, ethical stewards, and strategic enablers. It begins with an exploration of leader character, reminding us that effective governance is rooted in the personal virtues and ethical dispositions of individual board members. From there, it moves to the transformative potential of AI, which can amplify the cognitive capacities of boards while raising important questions about the boundaries between insight and overreach.

As we delve deeper, the focus shifts to behavioral dynamics, revealing how traits like CEO overconfidence can distort decision-making and alter firm complexity — an insight that boards must heed, especially during leadership transitions. The role of LIDs then comes into view, offering a structural lever to promote transparency, balance authority, and foster dialogue in evolving governance contexts.

Insights from the study of Brazilian boards underscore the critical importance of committee design and structural capacity, particularly for governing innovation in a fast-changing environment. Finally, the issue concludes with a call to view boards not just as formal governance bodies but as strategic institutions that can embed expertise, transfer soft and hard skills, and foster long-term value through thoughtful engagement.

In short, board effectiveness doesn't stem from operational closeness or retrospective insight, but from a purposeful integration of character, capabilities, structure, and strategic vision — all working in concert to support thoughtful, future-oriented governance in an increasingly complex world.

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About the guest editor

MIRKO BENISCHKE

Mirko Benischke is Associate Professor in the Department of Strategic Management and Entrepreneurship, Rotterdam School of Management, Erasmus University, the Netherlands. His research focuses on three main themes: strategic decision-making of senior executives, including CEOs, top management teams, and board of directors; multinational enterprise strategy; and climate change adaptation. Dr. Benischke's research has been published in leading academic journals, including *Harvard Business Review*. He earned a master of commerce degree and a PhD in international business, both from the University of Auckland, New Zealand. He can be reached at benischke@rsm.nl.

BOARDS UNDER FIRE:

FULFILLING FIDUCIARY DUTY IN AN ESG ENVIRONMENT

Author

Trevor Hunter

Historically, the frame of reference for corporate governance decision-making was largely defined by shareholder primacy, emphasizing the need to maximize returns for investors. Over the past decade, this perspective has evolved as the responsibilities of boards, and the expectations placed on them, have expanded to encompass a broader range of stakeholders.

In 2019, it became clear just how mainstream this change had become when the Business Roundtable (a lobby group of over 200 CEOs of some of the largest companies in the world, known for decades as a staunch supporter of shareholder capitalism) issued a revised statement on the purpose of a corporation. The group noted that, for years, its official policy held that corporations exist primarily to serve their shareholders.[1] In its revised statement, it said there is a need to shift from the traditional shareholder-first model to a perspective of corporate responsibility, equating the needs of employees, customers, suppliers, and communities with those of shareholders.

Simultaneously, societal, regulatory, and investor expectations regarding environmental, social, and governance (ESG) factors have reshaped corporate decision-making, emphasizing sustainability, ethical leadership, and long-term value creation over short-term profits. Prompted and supported by the United Nations's Principles for Responsible Investment (PRI), ESG has become a force through which many institutional investors have been able to influence the actions of corporate boards, not only by investing in firms that meet the PRI but by urging them to incorporate ESG considerations into their strategies.[2]

> **SIMULTANEOUSLY, SOCIETAL, REGULATORY & INVESTOR EXPECTATIONS REGARDING ESG FACTORS HAVE RESHAPED CORPORATE DECISION-MAKING**

Corporate governance plays a fundamental role in ensuring that organizations operate within the PRI through a board's fulfillment of its fiduciary duty. This duty is not merely a function of regulatory compliance or financial expertise. Rather, it is profoundly influenced by the character of board members. Leader character, which includes virtues such as integrity, accountability, humility, and courage, directly affects how boards oversee management, mitigate risks, and uphold shareholder and stakeholder interests to meet ESG expectations.

This article explores how leader character enhances corporate boards' decision-making ability to better fulfill their fiduciary duty in a governance landscape due to stakeholder ESG expectations, which increasingly require the ability to look beyond shareholder primacy and be more cognizant of the many stakeholder concerns within their complex operating environments. The article also examines how boards can cultivate leader character to align with evolving stakeholder and investor expectations.

THE LEADER CHARACTER FRAMEWORK

The Leader Character Framework, developed by Mary Crossan, Gerard Seijts, and Jeffrey Gandz of the Ivey Business School, identifies interconnected dimensions with judgment at the center.[3] This research sought to bridge the gap between instrumental competencies and the often-overlooked role of character in effective leadership.

Traditional leadership models emphasize competencies; these researchers found that leader character plays a fundamental role in decision-making, ethical behavior, and long-term organizational success. Their findings were informed by interviews with senior executives, empirical studies on leadership failures, and insights from disciplines such as philosophy, psychology, and management science.

The 11 dimensions of leader character are:

1. **Integrity** — acting honestly and consistently with personal ethical principles
2. **Humility** — being open to feedback and learning, recognizing limitations, acknowledging mistakes, and valuing diverse perspectives
3. **Courage** — standing up for ethical principles despite opposition to "doing the right thing"
4. **Accountability** — taking ownership of and responsibility for decisions and actions
5. **Drive** — demonstrating determination, perseverance, and initiative
6. **Temperance** — exercising self-control and composure under pressure
7. **Collaboration** — valuing teamwork and positive relationships
8. **Justice** — ensuring fairness and minimization of personal biases
9. **Transcendence** — having a sense of purpose as well as a commitment to it
10. **Humanity** — demonstrating empathy and compassion toward others
11. **Judgment** — making sound decisions in a timely manner based on relevant information and critical analysis of facts

Judgment serves as the integrating factor of all the leader character dimensions. Through judgment, leader character–informed decision-making is manifested and operationalized. Without strong judgment, even well-intended leaders may struggle to balance competing interests and navigate ethical dilemmas effectively.

The concepts represented in this framework provide a guide for boards to embed leader character into all decision-making processes and are particularly salient as they strive to meet their fiduciary duty in today's governance environment.

FIDUCIARY DUTY

Boards of directors' decision-making must be guided by adherence to their fiduciary duty. A board's fiduciary duty represents its overarching legal and ethical obligation to act in the best interests of the corporation. This duty is grounded in principles of loyalty, good faith, and care, ensuring that directors prioritize the corporation's long-term success rather than personal interests when making decisions. In the past, courts and regulators have interpreted fiduciary duty as requiring directors to make informed, prudent, and disinterested decisions that align with the company's objectives and long-term viability to maximize shareholder wealth.

In recent years, as ESG and PRI expectations have been incorporated into boards' decision-making contexts, the concept of fiduciary duty has been extended beyond compliance with legal requirements and shareholder primacy to encompass ethical governance, strategic oversight, and (increasingly) accountability to a broader set of stakeholders, such as the environment, the community, and customers. As such, boards now must possess traits and abilities beyond instrumental skills like financial acumen and strategic planning.

The notion of possessing the leader character traits needed to make decisions beyond the narrow aspect of shareholder primacy directly relates to a new aspect of duty of care. Within fiduciary duty, duty of care is a specific requirement that directors be able to act diligently, prudently, and competently when making decisions on behalf of the corporation. This means board members must not only actively engage in corporate affairs, thoroughly review materials, seek expert advice when necessary, and critically assess risks and opportunities, they must also possess the capabilities to make informed decisions.

A failure to uphold duty of care (e.g., failing to adequately oversee executive decisions, ignoring warning signs of financial or ethical misconduct, or rubber-stamping management proposals) due to a lack of the skills required to provide such oversight can expose directors and the corporation to liability and reputational damage.

The bottom line is that stakeholder ESG expectations mean that boards only possessing instrumental skills may not be able to meet the changing definition of duty of care.

BOARDS UNDER FIRE

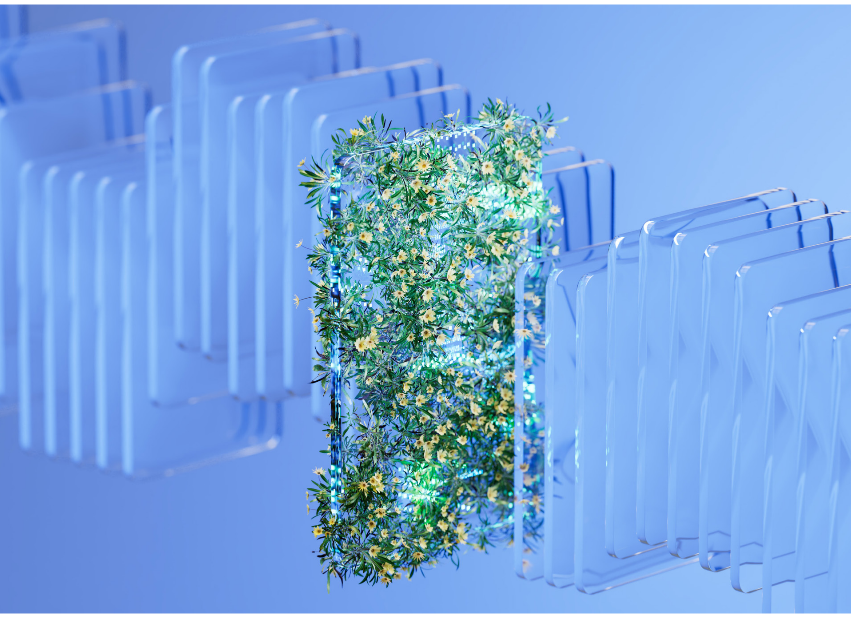
In today's governance landscape, the extent to which judgment is exercised by boards with respect to decision-making is increasingly questioned. Board members are expected to exercise sound judgment when making decisions (which ultimately translate into corporate strategy and operations) while balancing the ESG perspectives of stakeholders with diverse interests.

> **IN RECENT YEARS, THE CONCEPT OF FIDUCIARY DUTY HAS BEEN EXTENDED BEYOND COMPLIANCE**

This is difficult because the expectations of non-shareholders may counter the notion of shareholder wealth maximization. Corporate directors are legally and ethically obligated to act in the best interests of the corporation. The fiduciary duty they bear requires a commitment to principles of loyalty, good faith, and integrity. Embracing and following the tenants of leader character can play a critical role in helping boards uphold these obligations while considering the firm's societal obligations to ensure ethical governance and its long-term viability.

Courage empowers boards to make difficult but necessary decisions and to accept responsibility for the outcome. Courage-backed decision-making combined with **justice** and **humanity**, plays a key role with respect to boards addressing ESG and PRI concerns, as directors must challenge outdated norms and advocate for sustainable business practices, even when faced with resistance.

Speaking out against unethical management practices or pushing for long-term ESG commitments in the face of short-term financial pressures requires both moral and intellectual courage. Board members who demonstrate **transcendence** and courage understand their purpose in fulfilling their fiduciary duty such that their organizations remain on the right path, even in the face of external pressures or internal disagreements. For example, Unilever, long known for its sustainability initiatives, effectively doubled down on its efforts by restructuring and more deeply integrating sustainability goals into all aspects of its operations (despite anti-ESG pressure) to stay true to its purpose.[4]



Accountability ensures that board members take responsibility for their actions, uphold their commitments, and act transparently. Research shows the importance of accountability in fostering a culture of responsible leadership.[5] When boards emphasize accountability, they promote governance practices that discourage unethical behavior and create an environment of trust and reliability. Transparency further strengthens governance by ensuring that board members disclose potential conflicts of interest and maintain open communication with stakeholders.

The stakeholder-centric approach promoted by the Business Roundtable also necessitates intellectual **humility** from board members. Directors must recognize the complexity of modern corporate governance and be open to diverse perspectives from various stakeholders. This shift challenges traditional business assumptions, requiring leaders to embrace adaptability and ongoing learning. Leader character experts emphasize that intellectual humility, humanity, and a learning orientation contribute to adaptive governance, enabling boards to make informed and forward-thinking decisions.[6] Humility fosters openness to diverse perspectives and continuous learning to ensure that board members strive for continuous improvement of their own skills and knowledge while seeking to learn and implement governance best practices to better fulfill their duty of care.

Temperance is another crucial component of leader character, allowing board members to exercise restraint and self-regulation when making decisions. By maintaining a balanced perspective and avoiding impulsive actions, directors can navigate ethical dilemmas with composure and integrity. Leader character experts emphasize that temperance contributes to effective decision-making, enabling board members to act with fairness and impartiality.[7]

Diligence is a foundational element of the duty of care. Board members must actively engage in corporate affairs, attend meetings regularly, and thoroughly review financial reports and strategic plans. Directors who demonstrate diligence are more likely to challenge management assumptions, assess risks thoroughly, and contribute to effective decision-making. Experts argue that leader character traits such as **drive** and **collaboration** enhance diligence and therefore board effectiveness by fostering an environment where directors actively participate in discussions and work together to achieve corporate objectives.[8] For example, a collaborative mindset was integral to Microsoft CEO Satya Nadella's push into cloud computing with the Azure platform. He and the board worked together to shift the firm's priorities, turning the firm into an early mover and creating an industry-leading product.[9]

Integrity is perhaps the most essential aspect of leader character with respect to board decision-making, as it helps board members make ethical decisions, adhere to corporate policies, and resist pressures that might lead to self-serving behavior. Corporate scandals such as those at Enron and WorldCom serve as cautionary tales of what happens when board members and executives lack integrity. In these cases, compromised ethical standards led to fraudulent financial reporting, significant investor losses, and corporate collapses.

The shift toward ESG-focused governance further reinforces the importance of **judgment,** as directors must navigate complex trade-offs and long-term considerations. Investor pressure for initiatives such as greater transparency in sustainability reporting or ethical supply chain management requires boards to integrate ESG concerns into corporate strategy. By demonstrating leader character–informed judgment, board members can effectively respond to evolving investor expectations and maintain corporate credibility in the marketplace.

Judgment is particularly important in crisis situations, when boards must remain composed and proactive in addressing challenges. Whether facing a financial downturn, a cybersecurity threat, or a corporate scandal, directors must be capable of making good decisions. Poor decision-making during crises, as seen in the 2015 Volkswagen emissions scandal, often results from a failure to exercise strong leader character traits.[10]

DEVELOPING LEADER CHARACTER IN BOARDS

Leader character is a patterned behavior that can be developed within board members and the board as a whole. It is a concept that involves a combination of personal traits and group dynamics. Each director possesses some level of instrumental skills and leader character dimensions. The key to ensuring character-informed decision-making is to create an environment where this is fostered. In other words, the behavior becomes entrenched by deciding to do it, doing it, checking that it is being done, and looking for ways to keep getting better at doing it.

Incumbent directors can reinforce character-informed decision-making by creating an environment that promotes self-reflection and open discussions about ethical dilemmas and character-related challenges. Regular self-evaluations and peer reviews focusing on leader character dimensions can help identify areas for improvement and reinforce desired behaviors. Directors must be vigilant in ensuring they behave in accordance with leader character principles and embrace a notion of continuous improvement (part of the dimension of humility) to recognize that they can and should try to be better.

Boards must be proactive in seeking out leader character traits in their director succession planning and candidate evaluation processes. Boards can ensure that new directors' traits go beyond instrumental skills (financial acumen and strategic planning) to include those of leader character. Discussions with references regarding past behavior, evaluation tools from third-party consultants, and case-based interviews are good ways to evaluate a candidate's leader character traits.

Experienced board members and chairs play a pivotal role in shaping the character of newer directors through mentorship and as exemplars of leader character–based decision-making. Observational learning, in which less experienced members emulate the dimensions of leader character–based decision-making demonstrated by seasoned directors, is a powerful tool as it sets explicit and implicit behavioral norms.

These behaviors can be codified into committee and board terms of reference, policies, and codes of conduct. These documents can also be published so that stakeholders can see that boards embrace leader character as fundamental to their decision-making. Duly informed of boards' own leader-character-based behavioral expectations, stakeholders can better hold boards accountable, increasing the likelihood of better and more ethical governance.

CONCLUSION

Taking a purely shareholder-centric view is no longer acceptable in today's ESG environment. To fulfill their fiduciary duty, boards of directors must consider business imperatives while maintaining a clear understanding of the needs and requirements of multiple stakeholders that, due to the nature of their diversity, may themselves be in conflict.

Boards must use judgment that is informed by more than the instrumental skills most often used as board membership criteria, embedding leader character into their governance practices and perspectives.

Boards that display leader character have the courage, drive, and humility to strive to be better. With notions of justice, humanity, and temperance, they are given a sense of purpose to fulfill their fiduciary duty with integrity. If accepted as the key criteria for board membership and the framework from which governance activities spring, decisions and outcomes that lead to better firm and social performance will greatly increase.

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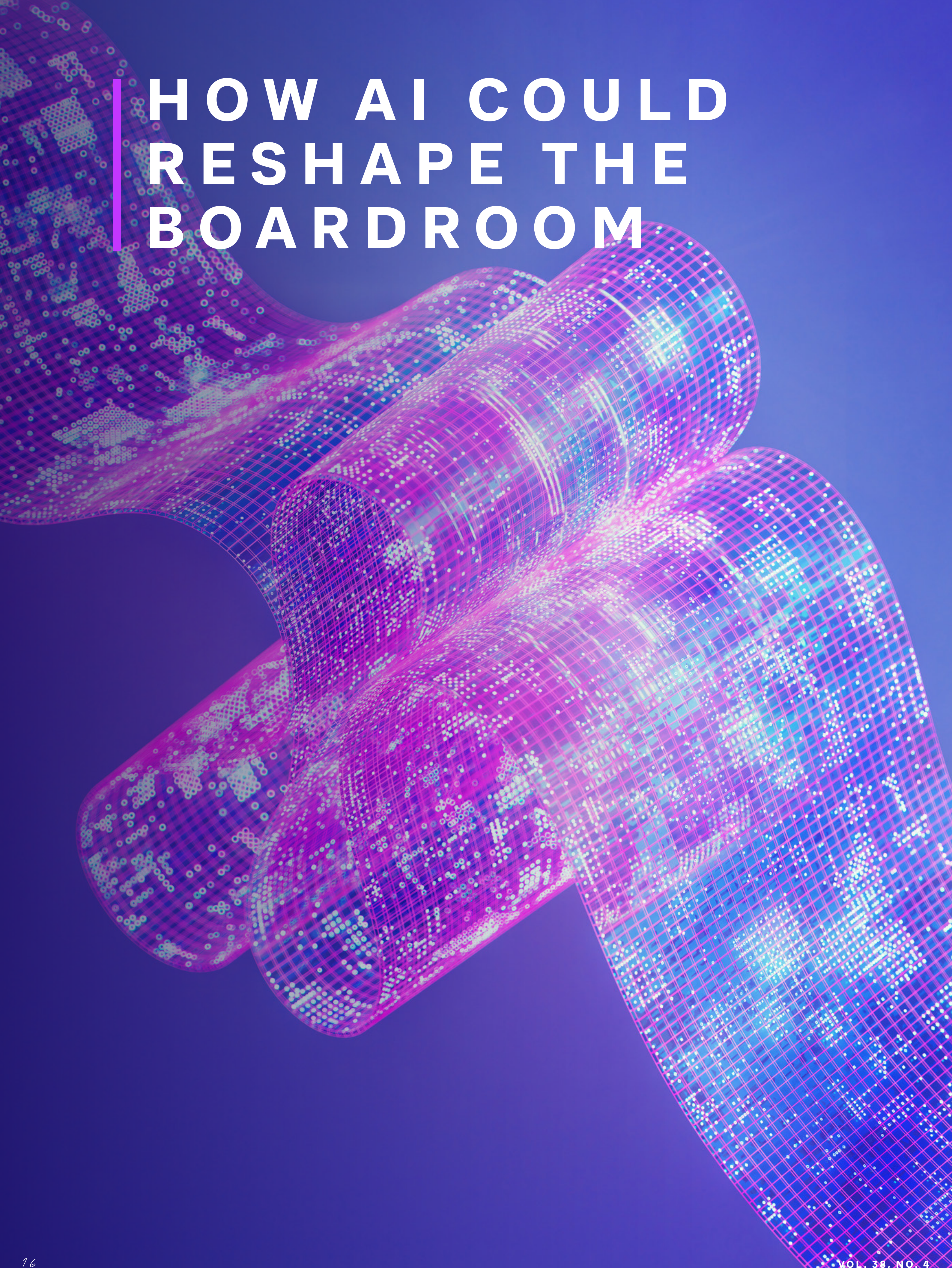
About the author

Trevor Hunter is Associate Professor of Governance and Management at King's University College, Canada. For 25 years, he has been involved with nonprofit governance as a researcher, professor, consultant, and director. Dr. Hunter is currently a member of the boards of Museum London and the London International Airport Authority. His research has been published in the *Journal of Business Ethics, Journal of Nonprofit Education and Leadership, Ivey Business Journal,* and *Journal of Cleaner Production and Sustainability*. Dr. Hunter has presented his work at leading conferences, including the annual meetings of the Academy of Management, Academy of International Business, Strategic Management Society, Administrative Science Association of Canada, Greening of Industry Network, Association for Research on Nonprofit Organizations and Voluntary Action, and the Conference Board of Canada. He was a member of King's University College Foundation board, the Governance Capacity Building Committee of the Ontario Association of Children's Aid Societies, Chair of the Governance Committee of the Middlesex-London Board of Health, a member of the Youth Opportunities Unlimited board, Board Chair at the London Small Business Centre, and board member of the Southwestern Ontario Chapter of the Institute of Corporate Directors. Dr. Hunter also cofounded and is former Vice Chair of Airshow London. He earned a PhD from Ivey Business School, Western University, Canada. He can be reached at thunter6@uwo.ca.

HOW AI COULD RESHAPE THE BOARDROOM



Authors

David F. Larcker, Amit Seru,
Brian Tayan, and Laurie Yoler

AI has the potential to significantly transform many aspects of corporate activity, including decision-making, productivity, customer experience, and content creation. The impact on boardrooms is likely to be significant — but perhaps in different ways than is commonly recognized.

Boards are aware of the enormous potential of AI. According to one survey, corporate leaders rank "increasing the use of AI across the organization" above all other priorities for the coming year, including such staples as revenue growth, productivity, margin improvement, and strategic opportunities. Boards have also been busy determining the organizational use of AI, its competitive impact, level of financial investment, training, guidelines, and reputational risk.[1]

Much less consideration has been paid to the ways the application of AI can reshape the operations and practices of the board itself, with the prospect of substantially improving corporate governance quality. Four areas in particular are poised for impact:

1. How boards function
2. How boards process information
3. How boards interact with management, and management with boards
4. How board advisers contribute

Although AI has the potential to dramatically alter board practices, its adoption also raises important questions about how to maintain the line between board and managerial responsibilities, as well as how expectations on each side will change.

TRADITIONAL VIEW OF GOVERNANCE

Effective corporate governance relies on the separation of managerial and board responsibilities. Management runs the corporation, and the board oversees management to ensure its actions are in the interest of shareholders. In the absence of red flags, the board is permitted to rely on information provided by management to inform its decisions and carry out this oversight role.[2] Because the board is not involved in day-to-day operations, an information asymmetry exists between what the board and management know about the organization. In some situations, this information asymmetry can be severe.

> **EFFECTIVE CORPORATE GOVERNANCE RELIES ON THE SEPARATION OF MANAGERIAL & BOARD RESPONSIBILITIES**

Current board practices reflect how boards operate under this constraint. Management presents information through regularly scheduled board meetings, committee meetings, and ad hoc communications. Boards respond to this information by asking questions and requesting additional information as needed. For some matters, the board contracts with a third party (e.g., consultant, banker, auditor) to provide market information or an external perspective on best practices. Under this arrangement (assuming the board makes decisions with due deliberation and without conflict of interests), it will have satisfied its fiduciary duty to shareholders.

Unfortunately, plenty of examples point to the insufficiency of this arrangement. Many boards have been woefully uninformed about the financial, operating, and strategic risk of management decisions — as borne out by repeated examples of corporate meltdowns over the years. Boards have erred in situations of CEO selection, financial reporting, product liability, compensation setting, and reputation management. One study underscored a surprising disconnect between the information board members *say* are important drivers of corporate performance and the information and metrics boards *actually receive* to monitor this performance. Although the proximate cause of the failure identified in the study was the choice of KPIs, the fundamental problem is an issue of information flow between management and the board.

IMPACT OF AI ON GOVERNANCE

AI has the potential to change this dynamic. First, it can increase the volume, type, and quality of information available to management and boards. By making this information readily available, it reduces information asymmetry between management and directors. Board members are much less likely to be “in the dark” about the operating and governance realities of their companies because technology makes it easier for them to search and synthesize public and private information made available to them through AI board tools.

Second, AI increases the burden on both parties to review, synthesize, and analyze information prior to board meetings. Managers and directors can expect to spend more time on meeting preparation because the quantity of available knowledge is substantially greater. Elementary information that was previously reviewed during meetings will be expected to be analyzed and digested before the meeting.[3]

Third, AI allows for the supplementation (and, in some cases, replacement) of information provided by third-party advisers and consultants. Furthermore, AI can increase the breadth of analysis available to the board, coupling the retrospective review of mostly historical data (prevalent today) with more powerful tools for predictive and trend analysis. These tools will allow boards to be more *proactive* and less *reactive*.

At the same time, the adoption of AI in the boardroom will raise significant questions. The most important is about expectations for board contribution. Current governance practice generally places board members in a responsive position to management and the information it provides (the type, structure, and framing of this information).[4] With AI, directors will have access to information that is orders of magnitude beyond management-prepared board materials. AI tools can prompt board members with key questions based on the agenda and suggest analyses that could help reach a decision, such as benchmarking against competitors or linking data to reveal trends. Expectations for a director’s diligence in reviewing and preparing this information will be exponentially higher, and the quality of questions, challenges, and insights should be correspondingly higher.

Of course, executives will have the opportunity to try out their presentations on an AI interface that can prepare them for the questions they should expect. By (confidentially) asking, "What are the greatest weaknesses in the arguments I have made?" and "What are the potential flaws in my proposal?" executives should be better positioned to anticipate and respond to challenges raised by their boards.

A related question is about possible limits to the information boards should/will have access to. In theory, granting directors access to an AI interface that has full access to all data in the corporate data repository means directors have no limit (relative to management) to the information they can access. From a legal perspective, however, boards might not want unrestricted access. Where and how to draw the line (and what information is ring-fenced) requires careful thinking. Boards and their counsel will have to establish protocols about how the board would rely on, for example, AI analysis conducted by an individual director (not provided by management). The impact this will have on fiduciary expectations is unknown.[5]

Furthermore, protection of this data from cybersecurity threats must be a central consideration. Given the sensitivity and proprietary nature of the data fed into AI models, significant steps should be taken to protect against unauthorized access. The risk will be higher for large corporations with multiple connection points to suppliers, customers, and employees.

APPLICATION TO GOVERNANCE FUNCTIONS

AI also has the potential to alter the process by which boards fulfill specific governance obligations:

- **Strategy.** AI will allow boards and management richer access to scenario planning, assumption testing, risk identification, and investment prioritization. Some of the work that was previously outsourced to strategy consultants will be available in-house, at a lower cost and turnaround time. Boards will be able to compare AI's recommendations against those of external strategy consultants.
- **Compensation.** The compensation committee will have access to analytical and benchmarking tools to evaluate compensation design against a more flexible set of peer institutions. Rather than waiting for external consultants to rerun analyses against predesignated peer groups, boards, and their advisers will be able to analyze the sensitivity of pay to peer groups selection in real time, predict proxy adviser recommendations, and consider tax and legal implications. This is especially plausible because public compensation data is already available in electronic form.[6]
- **Human capital management.** AI tools will let boards perform advanced analytics on information in the company's human capital management databases, apply pattern recognition to workforce data, identify skills gaps, and perform long-range workforce and diversity forecasting.
- **Audit.** The audit committee will have access to surveillance tools that look for internal control weaknesses and identify potential fraud. The external auditor will also have access to AI tools that can provide reasonableness checks on a broader scope of transactions. The audit committee will have to consider the risks and ethical considerations of automating the audit process, including how and when to apply human judgment to a more automated process.
- **Legal.** AI technology will enable monitoring and summarization of emerging legal and regulatory developments, including lawsuits and enforcement actions at other corporations that might have a bearing on the company's activities. Directors will have access to alternative legal opinions and cases in real time.
- **Board evaluations.** AI can also be leveraged to track, review, and analyze board effectiveness, at both the individual and board levels. AI-driven coaching and advisory tools will be able to replace work that is currently performed through survey forms, helping boards measure their engagement, evaluate how they allocate their time and focus, and determine whether they are primarily reactive or proactive.[7]

A significant portion of this analysis is likely to supplant or supplement work currently performed by paid advisers.

ADDITIONAL BENEFITS & RISKS

As AI is introduced to the boardroom, boards will be able to conduct real-time analysis led by management, advisers, or board members themselves. Alternative or supplemental information that is missing can be searched for and brought in during the discussion. This will increase the cadence of meetings and reduce decision-making delays, as less time is needed to wait on analysis conducted "between meetings." This will allow for more robust scenario planning and potentially richer suggestions. Management will benefit from more sophisticated meeting preparation. They will be able to run simulation tests of their own presentations and ask AI to pose tough questions.

The application of this technology to the boardroom poses potential risks and challenges, however. One challenge is overcoming the wedge created between companies operating in an environment where competitors are predominantly private versus publicly traded. Public companies are subject to extensive disclosure requirements, and information about their operations and performance is publicly available. Private companies operate with fewer disclosure requirements. Depending on their competitive set, companies will have to think differently about the information they feed into models and how to perform benchmarking analysis using public, audited data versus privately sourced data that may carry inaccuracies or biases.

Another major risk is the substantial number of errors generated by current AI models. AI models come with inherent biases, the quality and availability of data can vary, and competitive intelligence may introduce additional complexities. AI makes computational and mathematical errors. It also does not always say "I don't know" to questions it might not know an answer to, instead grabbing available data that's not directly applicable to answer a question. Boards and managers must learn how to fact-check AI output before relying on it. This will require deeper (human) familiarity with the data. Boards will need to be educated on these and other limitations of this technology.[8]

AI monitoring will also likely generate a high number of red flags related to internal and external practices or threats. Boards will have to consider materiality risk in determining which risks require additional investigation, how to prioritize them, and how not to create a paper trail that increases the board's liability.

With the cost of analysis dramatically reduced, board members will have to train themselves not to fall victim to excessive analysis ("analysis paralysis") and stay focused on practical and efficient outcomes that benefit the corporation and its stakeholders. To this end, board and committee chairs will need to exhibit strong leadership skills to manage meeting dynamics effectively and ensure that analyses and conversations remain on track.

CONCLUSION: WHY THIS MATTERS

As AI enters the boardroom, its influence will extend far beyond technology adoption — reshaping governance roles, decision-making dynamics, and expectations for both directors and managers:

- **AI offers the potential to transform many corporate practices,** including corporate governance. With the adoption of this technology in the boardroom, directors will essentially have a real-time adviser at hand. This will reduce information asymmetries between the board and management, allowing directors to be more proactive in identifying matters requiring attention. It also has the potential to significantly increase the time requirements of director and committee membership, as directors review, test, and synthesize information made available to them. They will need to ask: How will AI change board processes, practices, and dynamics? Are current directors equipped to adapt to this change? What training, resources, advice, and counsel will be needed to navigate it? How can directors embrace a larger role in analysis and decision-making without increasing their personal liability?

- **AI will offer benefits to managers in their interaction with boards.** Managers will effectively have a real-time board member by their side who can help them prepare for meetings, identify issues, and anticipate questions. Directors who do not contribute sufficiently will likely become more exposed. Companies will need to ask: How will managers react to a governance setting in which boards have more access and transparency into internal operations? How will directors respond to a setting in which technology interfaces can replicate many of their insights? Will AI in the boardroom lead to a general improvement in governance quality, or will failures of human and technological judgment continue to produce the same frequency of breakdowns that we witness today?
- **Finally, companies must consider these crucial questions:** At what point does a director's access to extensive AI-driven information and analysis begin to blur the line between governance and management? Who will ensure that directors do not overstep their role by asking questions that encroach on managerial responsibilities?

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3 This expectation is counter to that promised by commercial vendors. For example, in its marketing materials for AI board preparation technology, one company promises that AI will "supercharge meeting prep ... uncover how AI can turn hours of preparation into instant insights, delivering smart questions and ready-to-use data in seconds." In reality, companies that significantly increase information flow to directors report that it increases meeting prep time by raising expectations regarding the level of director preparedness. See: Larcker, David F., and Brian Tayan. "Netflix Approach to Governance: Genuine Transparency with the Board." Stanford Graduate School of Business, May 2018; and Lim, Phil. "Using AI for Enhanced Decision-Making: 9 Innovative Ways to Boost Board Efficiency and Effectiveness." Diligent, 24 July 2024.

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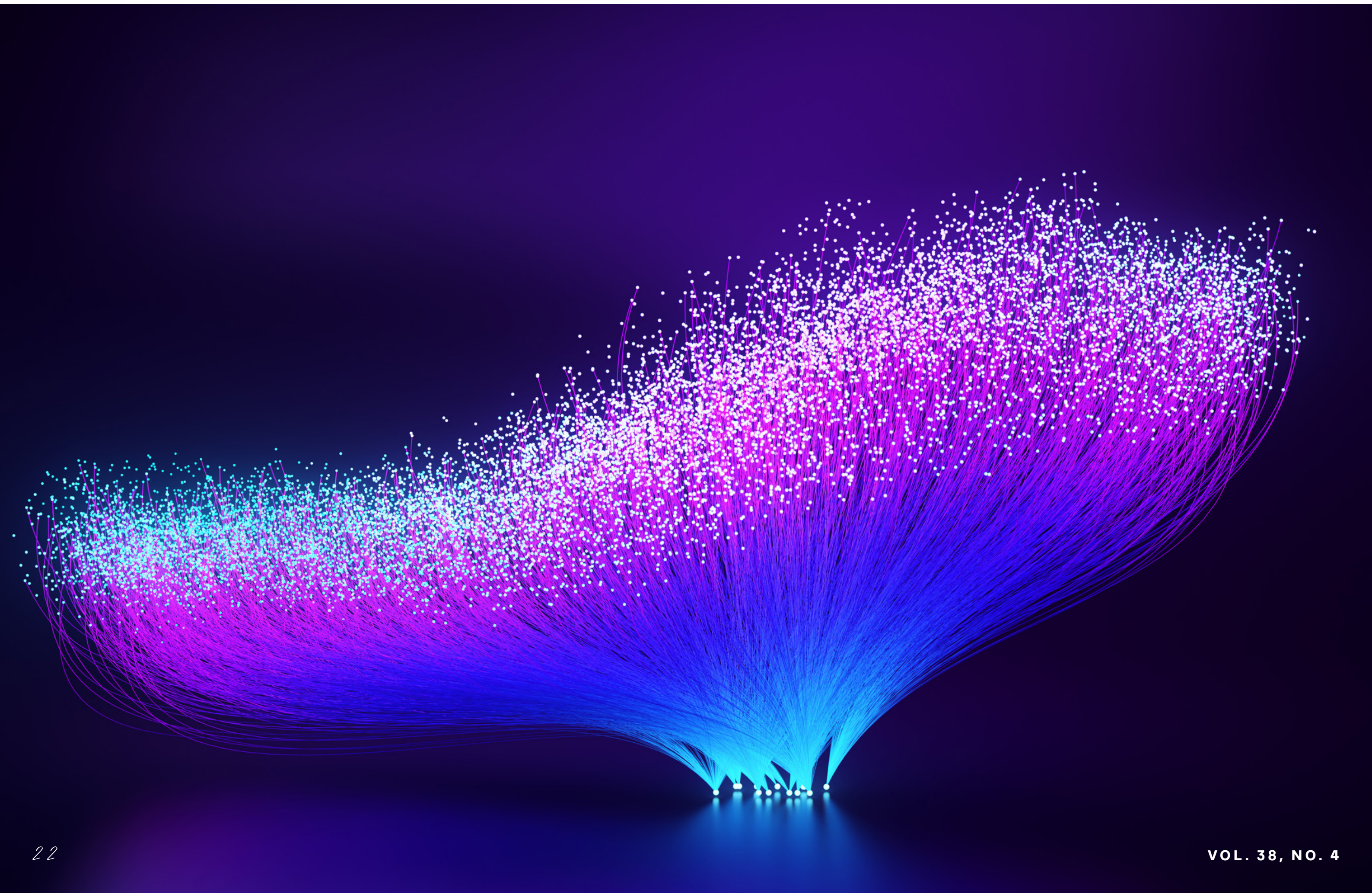
5 Directors are required to act with reasonable care in discharging their duties, including the obligation to make inquiries when confronted with red flags. A director conducting his/her own "research" through AI analysis may uncover activities or decisions that warrant further scrutiny. Failure to make inquiries might introduce legal complexities.

[6] For example, the compensation data firm Equilar offers an AI-powered proxy analysis tool called ERIC (Equilar Research Intelligence Copilot) that facilitates extraction and analysis of proxy data, including compensation data; see: "Equilar Introduces ERIC, an AI-Powered Proxy Analysis Tool." Press release, Equilar, 18 June 2024.

[7] Several tools available today use AI bots to record and summarize board meetings in real time; see: "AI Meeting Minutes Generator: The Future of Efficient Note-Taking." HR Future, accessed 2025.

[8] Computational and mathematical errors introduce potentially systemic issues, including in the areas of transportation, logistics, supply chain, capital markets, healthcare diagnoses, and natural disaster predictions.



About the authors

David Larcker is the James Irvin Miller Professor of Accounting (Emeritus) at Stanford Graduate School of Business, USA, and Co-Director of its Corporate Governance Research Initiative. He is a Distinguished Visiting Fellow at the Hoover Institution and Senior Faculty at the Rock Center for Corporate Governance. Renowned for his research on corporate governance and executive compensation, Dr. Larcker has been published in leading academic journals and is frequently cited in the media. He is coauthor (with Brian Tayan) of *Corporate Governance Matters, The Art and Practice of Corporate Governance,* and *A Real Look at Real World Corporate Governance*. Dr. Larcker serves on the board of trustees for Allspring Global Investments and has advised numerous companies and boards. Previously, he held faculty positions at the Wharton School of the University of Pennsylvania, USA, and the Kellogg School of Management of Northwestern University, USA. Dr. Larcker earned a PhD from the University of Kansas, USA. He can be reached at dlarcker@stanford.edu.

Amit Seru is the Steven and Roberta Denning Professor of Finance at Stanford Graduate School of Business, USA. He also serves as Senior Fellow at both the Hoover Institution and the Stanford Institute for Economic Policy Research and is a Research Associate at the National Bureau of Economic Research. Previously, Dr. Seru was on the faculty at the Booth School of the University of Chicago, USA. His research spans corporate finance, financial regulation, and technological innovation. Dr. Seru has been published in leading journals, and he has served as Editor for several leading financial publications. Dr. Seru has advised major regulatory agencies worldwide and has received prestigious awards, including recognition as "Top 25 Economists Under 45" by the International Monetary Fund. He holds degrees from the University of Delhi, India, and earned a PhD from the University of Michigan, USA. He can be reached at aseru@stanford.edu.

Brian Tayan is a researcher with the Corporate Governance Research Initiative at Stanford Graduate School of Business, USA. He is also a member of both the Rock Center for Corporate Governance and the Working Group on Corporate Governance at the Hoover Institution. Mr. Tayan is coauthor (with David Larcker) of *Corporate Governance Matters, The Art and Practice of Corporate Governance,* and *A Real Look at Real World Corporate Governance*. He earned a bachelor of arts degree from Princeton University, USA, and an MBA from Stanford Graduate School of Business. He can be reached at btayan@stanford.edu.

Laurie Yoler is an accomplished board director, venture capital investor, and strategist with expertise in disruptive technologies, including AI, cybersecurity, and robotics. She has served on more than 25 boards, notably as a founding board member of both Tesla and Zoox. Ms. Yoler currently serves on the boards of Church & Dwight and the Northern California Chapter of the National Association of Corporate Directors. She is also a partner at Playground Global, an investor with Broadway Angels and HealthTech Capital, and former President of Qualcomm Labs. Ms. Yoler graduated summa cum laude from Washington State University, USA, and holds executive education credentials from the Kellogg School of Management of Northwestern University, USA; Stanford Graduate School of Business, USA; and INSEAD. She can be reached at lyoler@gmail.com.

OVERCONFIDENT CEOS: SIMPLIFYING FIRMS & IGNORING RISKS

Authors

Shuhui Wang and Hirindu Kawshala

Despite growing recognition of firm complexity's influence on business development, little is known about what drives firm complexity itself.[1] CEOs influence how organizations are structured, yet the impact of their traits on firm complexity is not well understood. Given that CEO overconfidence influences risk-taking and decision-making, it may also play a role in shaping firm complexity, greatly affecting organizational efficiency and adaptability.

Firm complexity is an omnibus construct encompassing multiple dimensions, including operational, structural, and strategic intricacies.[2] Although a certain level of complexity can drive innovation, facilitate expansion, and enhance competitiveness, excessive complexity tends to hinder decision-making, increase costs, and reduce transparency for investors.

However, excessive complexity reduction can weaken essential structures, limiting a firm's ability to compete effectively in dynamic or highly regulated markets. Striking the right balance is essential.

CEOs shape firm complexity through their strategic decisions and managerial choices.[3] Overconfidence (a common trait among CEOs) leads them to overestimate their abilities while underestimating risks.[4] This tendency drives substantial changes in firm complexity by influencing investments and financing.[5]

Interestingly, despite its impact on corporate decision-making, the relationship between CEO overconfidence and firm complexity remains an underexplored issue.

WHY FIRM COMPLEXITY MATTERS

Firm complexity isn't just a buzzword, it's a double-edged sword for business. Some complexity, like diverse product lines or global operations, can spark innovation and provide a competitive edge.[6] However, excessive complexity hinders operational efficiency, inflates costs, and erodes investor confidence in financial reporting.[7]

Striking the right balance is crucial, but when CEOs are overconfident, they tend to either oversimplify or overcomplicate matters, potentially disrupting a firm's strategy and performance.

> **FIRM COMPLEXITY IS AN OMNIBUS CONSTRUCT ENCOMPASSING MULTIPLE DIMENSIONS**

Drawing on more than 14,564 firm-year observations from 2002 to 2023, we analyzed earnings conference call (ECC) transcripts to explore the impact of CEO overconfidence on firm complexity. This article describes our findings, explores what they mean for businesses, and offers clear, actionable steps to achieve balance.

OUR APPROACH

ECCs are a critical communications channel between corporate executives and investors, offering insights into firm performance, strategic initiatives, and future outlook. Typically, ECCs consist of a presentation, where executives share prepared remarks; a Q&A, where analysts and investors ask questions and executives respond; and a full transcript combining both. Analyzing them provides insight into how CEOs shape their presentations and gives us a way to assess the degree of firm complexity embedded in these discussions.

To measure firm complexity, we used a textual dictionary approach to analyze our data, which was pulled from multiple industries to ensure our findings reflect broader corporate trends rather than being limited to specific sectors. We aimed to capture firm complexity holistically and dynamically, moving beyond linguistic complexity to incorporate structural, operational, and strategic dimensions.

This approach, based on the omnibus firm complexity measure developed by Tim Loughran and Bill McDonald, ensures a comprehensive assessment of complexity, making it relevant for corporate boards, investors, and policymakers.[8]

By examining the frequency (how often) and patterns (how they appear) of complexity-related terminology used in ECC transcripts, we tracked the ways firm complexity evolved over time and varied across sectors. This enabled a deep understanding of how corporate decision-making, regulatory pressures, and market conditions shape a firm's overall complexity over time.

Figure 1 (a word cloud) and Figure 2 (a frequency chart) illustrate how often complexity-related terms are employed, highlighting the extent to which firms discuss complex organizational structures, operations, or strategies during their earnings calls. We created three complexity scores:

1. **Presentation complexity score (PCS)** — the level of complexity reflected in a firm's structured, high-level strategy discussions in the presentation
2. **Question and answer complexity score (QCS)** — the depth of firm-specific operational and strategic challenges revealed during the Q&A
3. **Total complexity score (TCS)** — a holistic measure of firm complexity achieved by combining the two scores above

Figure 1. A word cloud illustrating the most commonly used complexity-related words in ECC transcripts

Figure 3 shows a gradual decline in complexity, particularly after 2010, suggesting a shift toward reduced firm complexity. This trend aligns with our findings (described below) that overconfident CEOs tend to reduce firm complexity. The reduction may reflect attempts to streamline operations and decision-making, but it raises concerns about whether vital details and oversight structures are being diluted in the process.

OVERCONFIDENCE IDENTIFICATION

To identify overconfident CEOs, we employed a systematic, empirically grounded approach based on prior literature. We followed Ulrike Malmendier and Geoffrey Tate's methodology, which measures overconfidence by looking at a CEO's tendency to retain unexercised stock options that are "in the money," a behavior interpreted as excessive

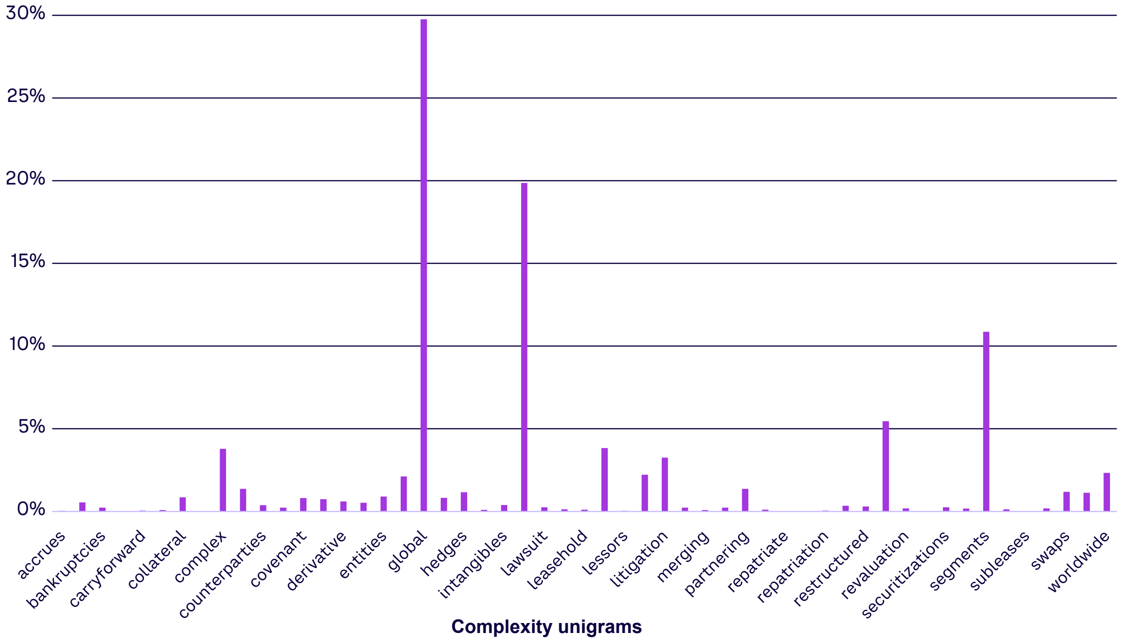


Figure 2. Frequency of the most commonly used complexity-related words in ECC transcripts

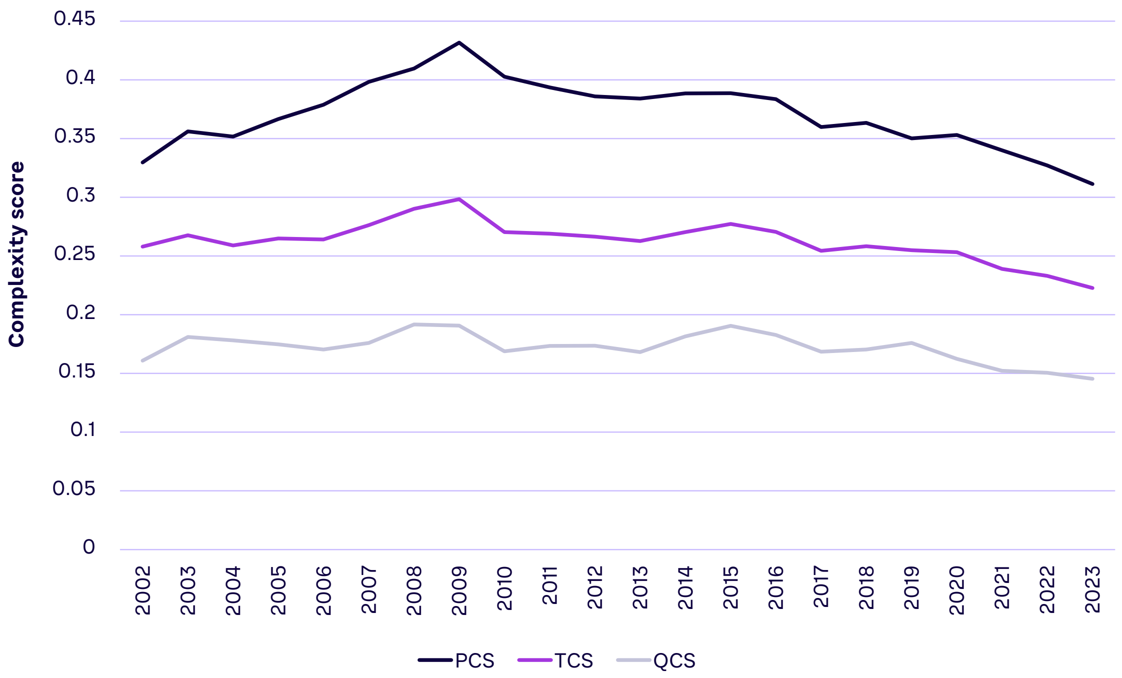
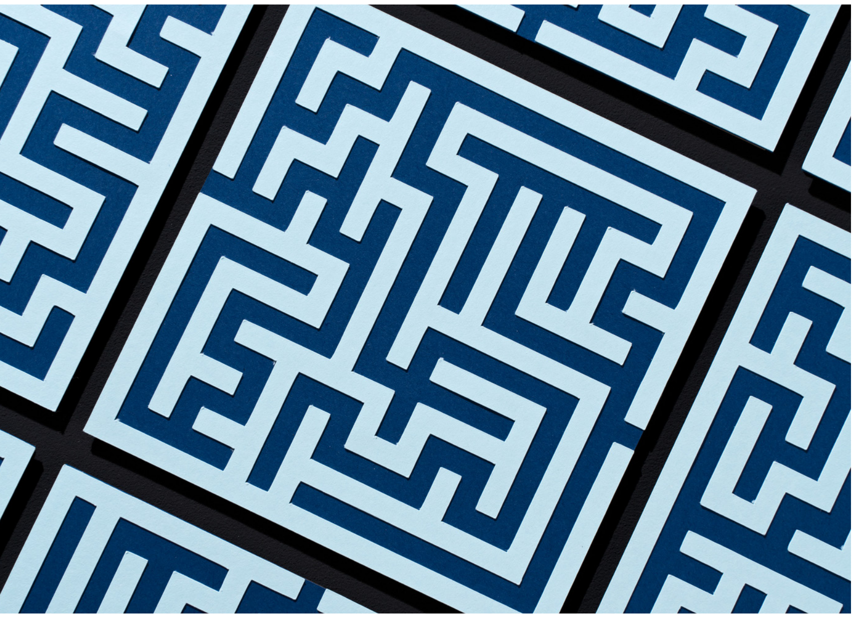


Figure 3. Trends in firm complexity over time

optimism about future firm performance.[9,10] Data for this measure was sourced from ExecuComp, which provides detailed executive-level compensation information necessary for calculating stock option holdings.

This measure of overconfidence has been widely validated and offers a reliable indicator of psychological traits. To enhance robustness, we applied industry-fixed effects to account for unobservable sector-specific characteristics that may affect firm complexity or executive behavior. By integrating a well-established behavioral proxy with rigorous econometric controls, our analysis offers a strong empirical foundation for examining how overconfident CEOs influence the complexity of firm operations and strategic communication.



WHAT WE DISCOVERED

Our findings reveal a consistent pattern: CEO overconfidence is associated with lower levels of firm complexity, as captured in ECC transcripts. The effect is economically meaningful; on average, firms led by overconfident CEOs exhibit 3.1% less complexity than those led by non-overconfident CEOs.

This reduction in firm complexity may indicate that overconfident CEOs intend to streamline operations and improve efficiency. However, it should also raise concerns. Oversimplification can weaken internal oversight and/or reduce the organization's capacity to manage diverse operations effectively. Boards and investors should exercise caution in interpreting a reduction in complexity as unequivocally positive. It may reflect underlying inefficiencies or oversights in internal decision-making processes that warrant further examination.

To contextualize these patterns, we examined variations across firm and CEO characteristics in our study:

- The average CEO age is 52, with an age range from 30 to 78, reflecting diverse leadership experiences.
- Approximately 32% of CEOs in our sample are classified as overconfident, based on established behavioral measures using ExecuComp data.
- The firms in our study differ substantially. The firm size (total assets) ranges from US $57.9 million to $482 billion. A wide range of market-to-book ratios (from 0.6 to more than 14) suggests that our sample includes a diverse set of firms, from mature, value-driven companies to high-growth firms that attract strong investor interest. More than half (55%) of the firms prioritize returning value to shareholders through regular cash payouts (dividends). Only 5.4% of firms engage in R&D spending, suggesting that innovation is not uniformly distributed.

These differences underscore that firm complexity and leadership style are not "one size fits all." Rather, they must align with the specific characteristics and strategic needs of each organization. The impact of CEO overconfidence on complexity should be interpreted in light of firm-specific contexts, such as age, size, industry, and strategic focus.

PRACTICAL IMPLICATIONS

With deeper insights into how CEO overconfidence affects firm complexity, corporate boards, executive leadership, and investors can better anticipate the level of complexity a firm may experience under various leadership styles.

Studies show that CEO overconfidence influences corporate decision-making, risk-taking, and investment strategies, which in turn shape the structural complexity of firms.[11,12]

For corporate boards, recognizing the impact of CEO traits on firm complexity can help board directors make informed decisions when selecting and appointing CEOs, ensuring that leadership aligns with the firm's strategic needs and operational demands. A thorough understanding of CEO traits and their implications for firm complexity is essential for boards, especially during leadership transitions.

For example, during John Flannery's short tenure at General Electric (GE), he initiated rapid divestitures and restructuring efforts intended to simplify GE's operations and sharpen strategic focus. These actions, marked by decisiveness and confidence, suggest his approach may have been overconfident in nature. Analysts and insiders noted that the changes lacked long-term alignment with GE's complex portfolio and operational structure. This led to investor uncertainty and insufficient performance recovery, resulting in Flannery stepping down after just 14 months as CEO.[13] This example highlights that simplification driven by overconfidence (especially if not well aligned with the firm) can be ineffective and even destabilizing.

For executive leadership, balancing complexity management with resilience is crucial. Reducing complexity can streamline decision-making and enhance efficiency, but overly aggressive simplification may undermine innovation, governance structures, and adaptability. Research suggests firms that carefully manage complexity rather than eliminate it tend to achieve better long-term performance outcomes.[14]

For instance, Tim Cook's leadership at Apple reflects a measured, disciplined approach. Unlike some executives who aggressively simplify firm structures without fully accounting for operational needs, Cook has maintained a focused product strategy while effectively managing complexity through robust systems and strong governance. Under his leadership, Apple streamlined its offerings (focusing on core products like the iPhone and Mac) while expanding into services, wearables, and global supply chains. This shows how confidence rooted in operational discipline, not overconfidence, can support both innovation and long-term adaptability. Cook's inclusive, consensus-driven style has strengthened Apple's governance, resilience, and performance.[15]

For investors, understanding the role of CEO traits in shaping complexity can provide early signals of risk and strategic direction. For example, a sudden reduction in complexity may indicate overconfident decision-making rather than a well-planned restructuring strategy. By analyzing complexity trends, investors can assess whether changes reflect a sustainable strategic shift or a deviation from sound management practices.

Ultimately, integrating CEO trait analysis into governance, leadership development, and investment decision-making can help firms achieve a sustainable balance between complexity and efficiency, ensuring long-term resilience and value creation.

A BALANCED STRATEGY

A firm's complexity is shaped by many factors, but one of the most overlooked is the personal traits of the CEO. Leadership style, cognitive biases, and decision-making tendencies directly impact how a firm structures its operations, manages risk, and navigates strategic challenges.

Among these traits, CEO overconfidence is particularly influential, as it drives bold, rapid decision-making that could streamline operations for efficiency or introduce unforeseen risks due to excessive simplification.

Although our study finds that overconfident CEOs often simplify firm structures, not all do. At WeWork, Adam Neumann's overconfidence led to fast growth and expansion into unrelated areas, making the company more complex.[16] This happened partly because there weren't strong governance controls in place to ensure executives could question his decisions. This shows that the effect of overconfidence on complexity depends not just on the CEO's actions, but also on how well the company's leadership is supervised.

Recognizing how CEO traits shape complexity is essential for corporate boards, executives, and investors, as it enables them to anticipate shifts in firm structure, ensure strategic oversight, and avoid governance pitfalls associated with unchecked leadership tendencies. A well-balanced complexity management strategy must align with the firm's long-term vision rather than be dictated by a CEO's personal leadership style.

Overconfident CEOs often make swift decisions aimed at simplifying organizational structures. Rapid simplification can introduce several challenges, including increased exposure to risk, resistance from key stakeholders, and a lack of clear performance tracking. Overconfidence may lead executives to bypass critical due diligence processes when entering new markets or launching new products, resulting in costly miscalculations. Additionally, sudden reductions in complexity can trigger pushback from employees and investors, particularly if key operational processes or oversight mechanisms are eliminated.

In the absence of clear performance tracking, firms may struggle to assess how complexity shifts influence long-term sustainability, creating potential blind spots in governance and risk management.

CONCLUSION

Our findings reveal that overconfident CEOs are more likely to simplify their firms, often reducing complexity across multiple dimensions. However, whether this simplification is beneficial depends on the nature of the firm, its industry, and its strategic goals. In some contexts (e.g., fast-moving consumer goods or logistics), streamlining may enhance efficiency and responsiveness. In contrast, firms operating in innovation-driven sectors like technology or healthcare need to maintain a certain level of complexity for flexibility and long-term value creation.

Boards should not view reduced complexity as inherently positive or negative. Instead, they should interpret it through the lens of CEO traits. Overconfident CEOs may underestimate the need for oversight or ignore operational complexity.

Boards and investors should critically evaluate whether complexity reductions reflect thoughtful strategic design or an overconfident leader's tendency to cut corners. Regular assessments of complexity, when paired with an understanding of executive personality, can make clear whether changes align with long-term resilience or risk eroding a firm's adaptive capacity.

Full empirical analyses, variable definitions, and summary statistics are available from the authors upon request.

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About the authors

Shuhui Wang is Assistant Professor of Finance at Surrey Business School, University of Surrey, UK. She has been published in leading international journals, including *British Journal of Management, The Financial Review*, and *International Review of Financial Analysis*. Dr. Wang earned a PhD in finance from the University of Surrey with a focus on executive compensation, corporate governance, CEO overconfidence, institutional investment, and corporate social responsibility. She can be reached at shuhui.wang@surrey.ac.uk.

Hirindu Kawshala is a final-year PhD candidate in finance at Surrey Business School, University of Surrey, UK. Her research lies at the intersection of behavioral finance, investor sentiment, firm complexity, and climate change, with a particular focus on applying Python-based textual analysis to earnings conference calls. Through this work, Ms. Kawshala aims to provide insights on how firm complexity and investor sentiment shape financial performance. She can be reached at hk00775@surrey.ac.uk.

WHEN ARE LEAD INDEPENDENT DIRECTORS ESSENTIAL & WHEN ARE THEY NOT?

Author

Alessia Falsarone

From societal shifts and geopolitical tensions to rapid technological advances and a surge of diverse stakeholders, corporate boards face unprecedented challenges that require new governance approaches. Traditional leadership structures, once taken for granted, are coming under scrutiny as companies strive for independence, transparency, and effective decision-making.

The lead independent director (LID) role emerged in the late 1990s and early 2000s as investors and governance experts pushed for stronger board independence, particularly in companies where the chair and CEO roles are combined. This shift followed high-profile scandals like Enron and WorldCom, prompting calls for greater accountability. Designed to provide independent leadership and a clear communications channel, LIDs have become key fixtures on many public company boards — often recommended or required by corporate governance codes and institutional investor guidelines.

Despite this, questions linger about when a LID is truly essential, when the role may be redundant, and how its responsibilities vary across organizations. Central to unlocking its potential is crafting clear, adaptable mandates that reflect each board's unique structure and governance needs.

This article explores the evolving role of LIDs across public, private, and government boards and introduces a framework to help boards decide if, when, and how to appoint a LID (see Table 1). By considering board structure, organizational context, stakeholder complexity, and regulatory dynamics, boards can tailor the LID role to boost governance and transparency effectively.

WHEN & WHY BOARDS NEED A LID

Investors seem to agree that, because independent directors are expected to safeguard stakeholders' interests, the presence of a LID can boost investment efficiency, especially in firms with weak governance, information asymmetry, and/or low-transparency financial reporting.

Often, appointing a LID arises from the need to balance power and preserve board independence. A common trigger is the combination of chair and CEO roles — a setup that concentrates leadership and can complicate oversight. This arrangement, prevalent in many corporations, raises concerns among investors and regulators about potential conflicts of interest.

> **LIDs HAVE BECOME KEY FIXTURES ON MANY PUBLIC COMPANY BOARDS**

DIMENSIONS	QUESTIONS	INSIGHTS
Board structure & leadership context	• Is the chair also the CEO? • Is the CEO the only inside director? • What is the board's size & diversity makeup?	Combined chair/CEO or CEO-only board **→ Strong case for LID** Smaller, less diverse boards **→ Strong case for LID**
Organizational type & governance environment	• Is it a public company under regulatory scrutiny/shareholder disputes? • Is it a private company with founder/family influence? • Is it a government/public entity with political accountability?	LID role adapts to organizational type & governance demands; shareholder activism or family succession planning **→ Strong case for LID**
Stakeholder complexity & expectations	• What is the number & diversity makeup of stakeholders? • Are there social/labor/regulatory pressures?	Greater complexity **→ Greater need for LID-driven transparency**
Current board dynamics & challenges	• Are there conflicts of interest or leadership tensions? • Are there communication gaps between management & directors? • Are there recent crises or contentious decisions?	LID-driven mediation **→ Strong case for board cohesion**
Potential contributions of the LID	• Will the LID strengthen board independence & oversight? • Will the LID facilitate open dialogue & transparency? • Will the LID act as liaison between management & independent directors? • Will the LID build stakeholder trust?	Stronger independence, communication & trust **→ Enhanced board effectiveness & stakeholder confidence**

Table 1. When and how to deploy a LID

In these cases, the LID acts as a counterbalance, chairing independent director sessions, setting agendas, and serving as liaison between the chair/CEO and the board. This fosters management accountability and balanced strategic discussion.[1] About half of US companies (but less than 10% of EU companies) combine the chair and CEO roles, making the LID a critical governance mechanism for investor confidence and regulatory compliance.[2]

Johnson & Johnson, where the roles are combined, uses a LID to safeguard board independence and oversee succession planning.[3] Microsoft, which separates chair and CEO roles, appoints a LID to enhance oversight and manage complex governance matters.[4]

Another prominent scenario involves a CEO-only board, in which the CEO is the sole inside director amid a board of independents. Amazon's board, under Jeff Bezos's leadership, exemplifies this dynamic. Bezos served as chair and CEO for many years, with independent directors guiding oversight. The LID role was crucial in balancing founder influence with independent governance, helping to maintain accountability during high-growth phases and complex strategic decisions. In recent years, Amazon's LID has served as the primary board contact for shareholders to engage with on matters such as the company's executive compensation program.[5]

Governance practices vary globally, and so does a LID's scope of responsibilities. In the US, LIDs are common, reflecting both the prevalence of activist investors and the regulatory expectations of increased dialogue and coordination in the midst of market disruptions. Europe, where chair and CEO roles are more often split, sees less need for LIDs, although countries like Germany increasingly recognize their relevance amid growing trends in workforce transformation and governance standards.[6,7] In Asia-Pacific, the appointment of LIDs is on the rise, aligned with investor demands for more nuanced oversight.[8] In addition, a growing network of small and medium-sized enterprises in each region has experienced increased governance demands in supply chain due diligence, prompting many to formalize roles like LID to enhance leadership accountability without adding complexity.[9]

Beyond structure, LIDs are key in boards facing leadership tensions or conflicts of interest. Their independence helps them mediate disputes, promote cohesion, and address critical issues constructively.

Although LIDs often strengthen oversight, the role isn't foolproof. Small private boards with limited governance complexity or strong independent chairs may find the role redundant or even counterproductive. In such cases, a clear governance culture and defined delegation of authorities can suffice. We must keep in mind that the Wells Fargo fake accounts scandal, which emerged in 2016, revealed governance failures despite having a designated LID. This reminds us that LIDs must have real authority, clear responsibilities, and be willing and able to drive active engagement.[10,11]

LIMITATIONS & CHALLENGES OF LIDS

Boards should recognize that the LID role, although valuable, involves limitations and challenges. LID effectiveness depends heavily on the board's culture and the support of fellow directors. In organizations where independent directors are passive or lack confidence, the LID may struggle to exert meaningful influence and risk, becoming a figurehead rather than a force for oversight.

In my experience, the LID's Achilles' heel is that overlapping roles (e.g., committee chairs or independent chairs) can blur accountabilities and weaken LID authority. This overlap often stems from unclear role definitions, which can be resolved through deliberate mandate design and board dialogue. Additionally, cultural and organizational factors (hierarchical norms or founder dominance) can limit the LID's independence and willingness to challenge management. Recognizing these risks is essential for designing clear mandates and cultivating board cultures that truly empower the LID.

Finally, appointing a LID may add unnecessary complexity to smaller boards with straightforward governance structures, creating extra layers of communications without proportional benefit. Boards should carefully weigh these challenges and tailor the LID role by defining clear mandates, ensuring role clarity, and fostering a supportive culture to maximize its effectiveness.

WHEN LIDS DON'T WORK AS INTENDED

There are several situations in which the LID role may fall short or complicate governance:

- **In boards with weak independent director engagement,** the LID may lack the support needed to influence decisions effectively.
- **If the chair remains overly dominant or unwilling to collaborate,** the LID's ability to balance power will be undermined.
- **When roles and responsibilities overlap with other board leaders** (committee chairs or independent chairs), confusion and inefficiency can arise.
- **In family or founder-led firms with resistant to formal governance changes,** the LID may be sidelined or ignored.
- **Overreliance on the LID can breed complacency,** causing other directors to relax their vigilance and disengage from active oversight.

Recognizing these pitfalls helps boards design roles and processes that empower the LID without creating unnecessary friction.

ESTABLISHING CLEAR LID MANDATES

To set your LID up for success, focus on these best practices:

- **Define clear responsibilities.** Specify duties such as liaising with management, engaging shareholders, and resolving board conflicts. *Example:* In a publicly listed company or a government entity, the LID's mandate may explicitly include quarterly shareholder outreach.
- **Customize the mandate.** Tailor it to your company's size, sector, ownership, and culture — no cookie-cutter roles here. *Example:* A family-owned firm can give the LID a stronger role in succession planning, reflecting its unique governance needs.
- **Empower with authority.** Ensure the LID can access necessary resources, information, and call special meetings independently. *Example:* The LID has a dedicated budget approved by the board to hire external independent advisors, enabling swift responses to emerging risks.

- **Review and update regularly.** Governance evolves; mandates should, too. Schedule periodic reviews to keep the role relevant. *Example:* After a major regulatory change, it is wise to consider updating the LID's mandate to include enhanced oversight of compliance.
- **Communicate widely.** Make sure all board members and key stakeholders understand the LID's role and authority. *Example:* Companies may choose to hold an annual orientation session spotlighting the LID's responsibilities as a way to foster board cohesion.

Following these practices helps ensure the LID is not just a title but a meaningful leadership position. Specifically, ensuring the LID has access to independent advisers is a game changer. In the boards I've worked with, this autonomy enabled swift navigation of emerging risks.

In an informal survey conducted in January–October 2023 among 80 participants in the University of Chicago's Circular Economy and Sustainable Business Management certificate program, I found that effective LID mandates can improve stakeholder engagement rates up to 90%, ensuring responsibilities are clear and actionable within organizations (see Figure 1 for more data).

TAILORING THE LID ROLE GLOBALLY

Governance cultures and regulatory environments shape how LIDs operate worldwide, underscoring the need for tailored mandates rather than one-size-fits-all solutions. For example, in Germany's two-tier board system, supervisory board chairs often fulfill functions similar to a LID, but firms are increasingly appointing LIDs to strengthen independent oversight amid changing labor market dynamics. In Japan, interest in LIDs is rising as companies seek transparency and global investor confidence despite traditionally hierarchical boards. Australia and Canada promote LIDs through governance codes emphasizing power balance and stakeholder dialogue, and Latin American adoption varies widely, often driven by investor pressure and evolving governance standards.

These international variations illustrate how crafting LID mandates requires sensitivity to local governance contexts, regulatory expectations, and cultural norms. Boards benefit from adapting the LID role to fit their unique environment, ensuring clarity, authority, and relevance.

Effective LID mandates improve stakeholder engagement rates up to **90%**

90%

10X
Communication efforts yield better understanding when the LID is an integral part of stakeholder outreach activities

7 out of 10
Employees feel more empowered when they see clear LID authority in governance bodies, leading to proactive engagement

3X
Organizations conducting regular reviews see a marked increase in mandate adherence & effectiveness

5 out of 10
Organizations report improved efficiency in board operations with customized mandates tailored to their specific needs

Figure 1. Clarity breeds adaptability

NUANCES ACROSS BOARD TYPES

LIDs take on distinct characteristics depending on the type of board they serve. Public companies, private firms, and government entities face unique governance pressures, stakeholder expectations, and operational realities that shape how the LID functions and the value the role can add.

PUBLIC BOARDS

In public companies, the LID often anchors governance amid regulator, shareholder, and market scrutiny. Operating under strict frameworks like US Security and Exchange Commission (SEC) rules, LIDs ensure independent directors have a strong voice, facilitate open management dialogue, and oversee strategic agendas addressing the ethical deployment of technology, skills-gap concerns, and more. Many S&P 500 firms appoint LIDs precisely because the chair and CEO roles are combined. Coca-Cola's LID exemplifies this by bridging independent directors and management, driving transparency and stakeholder engagement on AI and environmental and social responsibility.[12]

PRIVATE BOARDS

Private boards are often smaller and more closely held. Here, the LID role may be informal or absent, reflecting a culture valuing agility and founder influence. However, as private firms grow or prepare to go public, governance needs increase. LIDs can help balance founder control, oversee succession, and guide transitions.

GOVERNMENT & PUBLIC ENTITY BOARDS

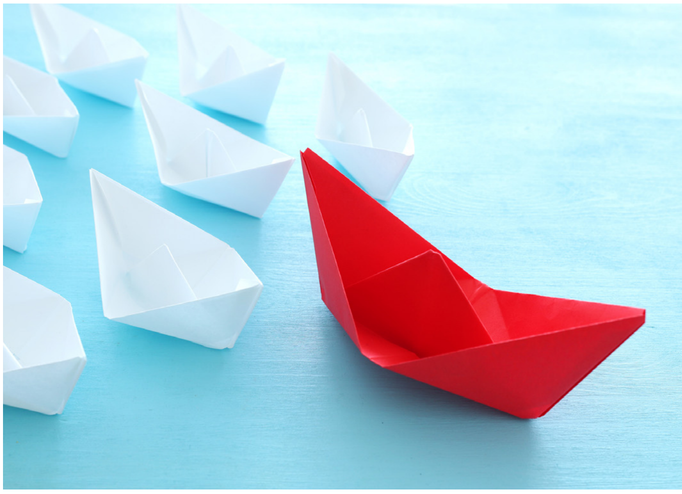
Boards of government agencies and public institutions face political oversight and public accountability. Here, LIDs act as stewards of legitimacy and trust, ensuring open, fair, and responsive decision-making. For example, the UK's National Health Service (NHS) trust boards similarly appoint senior independent directors as LIDs to uphold governance and transparency standards.[13]

Across board types, a LID's effectiveness depends on adapting the role to an organization's needs and governance culture. Rather than applying a uniform approach, boards should adapt LID mandates to fit their size, industry, stakeholders, and strategic goals.

THE LID AS A DRIVER OF TRANSPARENCY & EFFECTIVE DECISION-MAKING

Transparency and sound decisions are vital in today's complex governance environment. The LID plays a pivotal role as a trusted intermediary among directors, management, and stakeholders.

One primary contribution is fostering open, candid boardroom dialogue. By facilitating independent director discussions and providing confidential channels outside chair or CEO influence, the LID ensures that diverse perspectives shape deliberations.[14] This is especially important as boards wrestle with upskilling and re-skilling needs, AI ethics, and evolving regulations that demand nuanced, forward-looking approaches.



The LID also mediates contentious decisions, balancing competing interests and preserving unity. Their independence lets them navigate conflicts objectively, guiding consensus without diluting accountability.

Recently, Coca-Cola's LID led special board sessions on stakeholder engagement, transparent reporting, and governance of environmental and social commitments amid activist pressure on plastic and water use. These efforts can greatly uplift investor confidence and advance strategy-aligned sustainability practices.[15] Coca-Cola's example shows how an engaged LID can deepen board dialogue and strengthen trust on complex governance issues.

Externally, the LID is a critical contact for investors, regulators, and stakeholders seeking assurance of integrity and responsiveness. By embodying transparency and independence, the LID bolsters the board's credibility beyond its walls.

The LID's impact depends not only on role clarity but also on board culture and empowerment. Supported effectively, the LID can transform governance dynamics, fostering informed, balanced, and transparent decisions that align with stakeholder expectations.

DESIGNING AN EFFECTIVE LID MANDATE

To meet the growing demands of governance, boards should craft LID mandates that are clear, flexible, and tailored to their company. An effective mandate clarifies the LID's authority, covering areas such as facilitating independent director meetings, serving as a liaison between the board and management, and engaging with shareholders on key governance issues. It should also empower the LID to proactively address challenges like technological risks and talent management.

Mandates should reflect the company's size, sector, culture, and strategic priorities rather than relying on a one-size-fits-all model. Regular reviews of the mandate ensure it stays relevant as the business environment evolves. By designing a mandate that balances authority with accountability, boards can equip their LID to be a true catalyst for effective oversight and long-term value creation.

LOOKING AHEAD: THE EVOLVING ROLE OF THE LID

As AI technologies become more integral to business and labor markets continue to shift, the LID role will expand beyond traditional oversight. Innovation-driven companies will increasingly depend on LIDs to navigate the complex intersection of rapid technological change, ethical considerations, and talent dynamics. These directors will need to bridge the gap between cutting-edge innovation and responsible governance, ensuring that advances in AI don't outpace the company's ability to manage risks or support its workforce.

With labor market pressures mounting, the LID of the future will need to be a dynamic leader who is fluent in governance, technology, and human capital challenges — ready and able to steer companies confidently through a long-term innovation cycle.

CONCLUSION

The LID has a vital governance role to play in today's dynamic boardrooms. Although not universally required, the LID plays a crucial part in preserving board independence, enhancing transparency, and strengthening decision-making — especially when leadership power becomes more concentrated or challenges multiply.

Boards that carefully assess their unique structures, dynamics, and external pressures can better decide when and how to adopt or evolve the LID role. Given a clear mandate and supportive culture, the LID role becomes a flexible, practical tool to improve governance quality and build stakeholder trust.

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About the author

Alessia Falsarone is a non-executive director at Innovate UK Loans Ltd, the UK Government's innovation investment agency, and serves on the board of global insurer Generali Group. She chairs the Remuneration Committee at OpenCorporates Ltd, the world's largest provider of legal entity data solutions. With nearly three decades of leadership experience, Ms. Falsarone has held senior roles at major financial institutions, including AIG, Citigroup, and Credit Suisse, working across the US, Europe, and Asia. She is adjunct faculty at the University of Chicago, a fellow of the Aspen Institute, an award-winning author, and an NACD Directorship 100 honoree. Ms. Falsarone holds degrees from Stanford University (USA), Massachusetts Institute of Technology (USA), and Bocconi University (Italy). She can be reached at alessiaf@alumni.stanford.edu.

INNOVATION STARTS IN THE BOARDROOM & COMMITTEES ARE WHERE IT COMES TO LIFE

Authors

Filip Lestan and Ruy de Quadros Carvalho

Is your board built to innovate? If you ask directors where the heavy lifting of governance happens, few will say it is during boardroom presentations. The real work gets done in committees — smaller, focused, often underestimated teams where ideas are tested, risks are debated, and strategy is shaped.

This is especially true when it comes to innovation. In our recent study of 249 publicly listed Brazilian firms from 2005 to 2023, we found that the way boards are structured (and how their committees are formed) has a powerful effect on innovation-related governance. Yet far too many companies continue to treat the formation of strategy, innovation, development, technology, and risk committees as a formality, not a lever.

Our findings point to a single critical message for practitioners: boards do not innovate — committees do.

INNOVATION & BOARDS

Innovation has become the new North Star of corporate strategy. From ESG (environmental, social, and governance) and AI to climate resilience and digital disruption, companies are under pressure to not just adapt but to invent the future.

Boards know this. Innovation appears on nearly every corporate agenda, and directors are under pressure from investors, regulators, and society to act boldly. Paradoxically, although every board says innovation is a priority, few have structures in place to govern it effectively.

In many companies, innovation is treated as an execution challenge for management rather than a governance challenge for the board.[1] Our research reveals that board structure (specifically committee design) can make or break innovation capacity. Committees are where long-term bets are debated, risks are vetted, and strategic trade-offs are explored.[2] Innovation thrives when these spaces exist and falters when they do not.

BOARDS DO NOT INNOVATE — COMMITTEES DO

We studied Brazilian firms to understand how boards have approached innovation governance over the past two decades. What we found is clear: the way boards are structured, committees are formed, and directors are engaged matters far more than vision statements or innovation rhetoric.

This article offers a guide for boards that want to be ready for what's next. Based on evidence and pattern recognition from real firms, we show how committee design can empower — or inhibit — innovation. If your board wants to be fit for the future, it's time to look inward.

In today's economy, innovation does not just need investment; it needs governance. That begins with a single question: is your board built to innovate? Boards that want to be ready for the future must ask: Do we have the right committees? Are the right people on them? Do those committees have the time, talent, and mandate to shape innovation rather than just monitor it? Innovation starts in governance, and governance starts in committees.

BOARDS ARE EVOLVING & SO ARE COMMITTEES

Innovation governance is not static. It evolves over time and varies across boards.[3] By analyzing Brazilian firms, we can see how firms have gradually embraced innovation-related committees and how trends shifted in the last two decades.

As of 2024, strategy and risk committees are the most common innovation-related structures, each appearing in more than 25% of firms in our sample. Innovation committees, in contrast, are present in just over 14% of firms, and development and technology committees are even less frequent, with 4.8% and 3.6% adoption rates, respectively (see Figure 1).

This tells us two things. First, innovation governance remains relatively underutilized in Brazilian firms. Second, when innovation is governed, it is often done indirectly — through strategy and risk rather than through focused innovation or technology committees.

The story gets more interesting when we zoom out. Figure 2 shows the prevalence of five innovation-related committees from 2005 to 2023:

- There's been a steady, gradual increase in **strategy** and **risk** committees, suggesting growing awareness of strategic foresight and governance compliance.
- **Innovation** committees barely existed in 2005. They began to emerge post-2015, with noticeable growth during the pandemic years and into the early 2020s.
- **Technology** and **development** committees have increased in recent years, likely in response to digital transformation, cybersecurity challenges, and sustainability pressures.

It's clear that although adoption remains low in absolute terms, the direction is unmistakably upward. Firms are slowly expanding their governance toolkit to include structures more directly aligned with innovation imperatives.

FROM COMPLIANCE TO COMPETITIVENESS

In the past, committee formation was often compliance-driven, especially for audit and risk. More recently, we see a shift toward strategic governance that includes a focus on innovation. Boards are beginning to ask: "Where are we headed?" rather than just "Are we safe?"

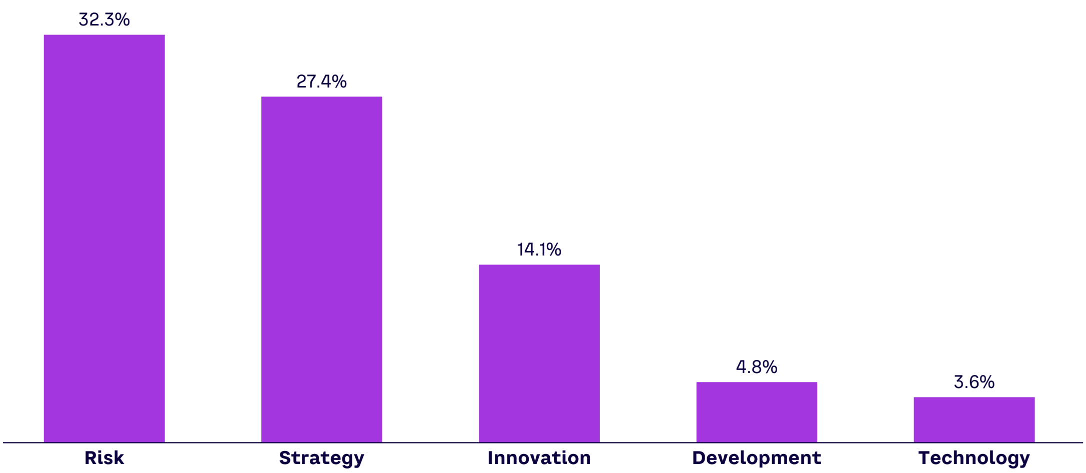

Figure 1. Distribution of innovation-related board committees, 2005–2023 (source: BoardEx)

__Reflection 1:__ Is your sector moving fast enough to justify a technology or innovation committee? If your competitors are forming these structures and you're not, what might you be missing?

Innovation-related board committees are not about micromanaging R&D. They are about ensuring the board is equipped to ask the right questions, evaluate emerging risks and opportunities, and provide sustained oversight on innovation initiatives.

Suzano Group, the world's largest producer of cellulose, is a pioneer in this area. It created a Strategy and Innovation Board advisory committee that played a key role in guiding the company's diversification into wood-based cellulose fibers. The committee was instrumental in a move to integrate innovation with sustainability, leading to the concept of "innovability" that now guides Suzano's strategy.

__Tip 1:__ Benchmark your board against peers in your sector. Review annual reports, governance disclosures, and investor presentations from leading competitors. If they have established innovation or technology committees (and you have not), that is a signal to reassess. Use this insight to initiate a conversation at the board level: What governance structures would better align us with where our industry is heading?

We identified three actions critical to ensuring that innovation-related board committees reach their full potential.

1. BIGGER BOARDS, BETTER OVERSIGHT?

One of the most common critiques of large boards is inefficiency. More voices, more politics, more slowdowns — or so the thinking goes.[4] But when it comes to fostering innovation, board size is not necessarily a burden. In fact, it can be an advantage. Our study found that larger boards are significantly more likely to form innovation-related committees, including those focused on strategy, risk, development, and technology. The reason is straightforward: large boards have the capacity to distribute workload, draw on more diverse expertise, and form specialized subgroups that dig deep into complex topics.

Committees create focus and accountability. Think about the innovation agenda. It often involves navigating long time horizons, technical ambiguity, and organizational resistance. A full board, meeting quarterly, is unlikely to give these issues the airtime or attention they need. But a dedicated innovation or technology committee, empowered and properly staffed, can.

For example, the Strategy and Innovation committee at Brazil's Embraer, the third world's largest manufacturer of civilian aircraft, played an important role in creating and supervising Embraer-X, a spinoff dedicated to corporate entrepreneurship based on disruptive technology. This move led to Eve Air Mobility, a New York Stock Exchange–listed independent company developing an electric vertical takeoff and landing aircraft. The size of the board, from nine to 11 directors, allows for the effective operation of advisory committees.

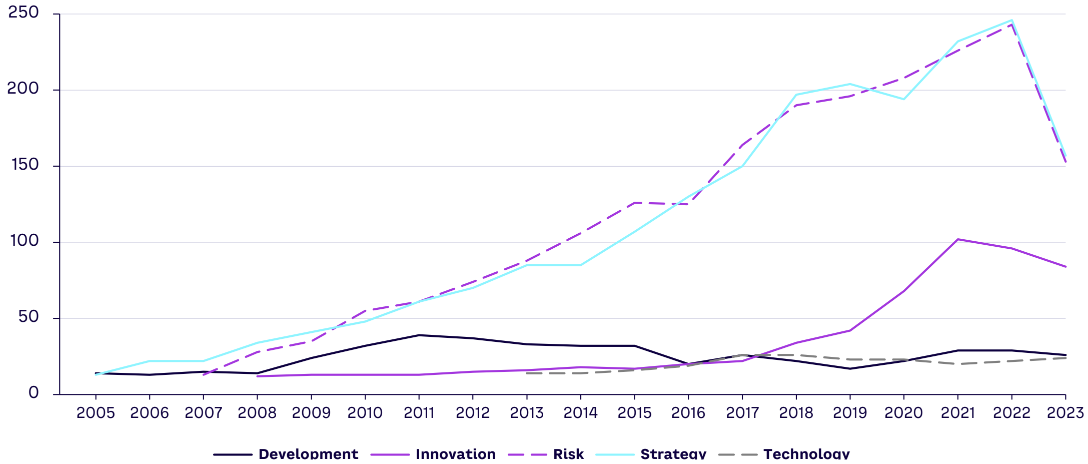

Figure 2. Evolution of innovation-related board committees, 2005–2023 (source: BoardEx)

This specialization also sharpens accountability. When a firm forms a technology committee, it signals that digital transformation is not just an operational issue; it's a board-level concern. When it creates a development committee, growth is not just a KPI; it is a governance priority.

We found that boards with eight or more members were significantly more likely to form multiple, well-differentiated committees. This runs counter to the minimalist trend some firms have embraced in the name of efficiency. But innovation is not always efficient. It is an iterative, long-term, resource-intensive process.

The real question is not whether the board is large or small. It is whether it has the structural agility to form the right committees, at the right time, with the right people.

Reflection 2: *Does the size of your board allow the formation of committees beyond audit and compensation? If not, how are innovation-related risks and opportunities being governed?*

Some boards resist expansion, fearing complexity. But our study found that larger boards have more innovation capacity because they can staff more specialized committees. With the right structure, bigger can mean smarter, all else being equal. However, our sample revealed that the prevalent trend is toward smaller boards (see Figure 3).

Tip 2: *Consider expanding your board if innovation, risk, or digital transformation are strategic priorities. More seats can mean more depth.*

2. WHEN THE CEO WEARS 2 HATS

In many firms, the CEO serves as board chair. This model is often justified as a way to streamline leadership and align strategy.[5] In theory, one person holds the vision, leads the execution, and oversees governance. In practice, this concentration of power brings risks, especially for innovation.

Our findings show that "CEO duality" is positively associated with the formation of strategy committees. That's logical: when a CEO also chairs the board, they are more likely to formalize support structures around their vision.[6] But we saw no statistically significant link between CEO duality and the creation of innovation-related committees, such as innovation, technology, development, or risk.

With centralized power comes narrow focus.[7] The implication is clear: CEO duality encourages top-down strategic focus but does not necessarily support the bottom-up, cross-functional structures that innovation requires. In fact, it may hinder them. When one person sets the agenda and chairs the discussion, there is less incentive to form committees that could challenge, complicate, or diffuse that authority.

This is not a theoretical concern. Innovation often involves friction: new ideas, uncomfortable trade-offs, and ambiguous outcomes. Committees provide a space where these tensions can be navigated without much worry about executive control. When dual roles dominate, the board may default to consensus rather than critical inquiry.

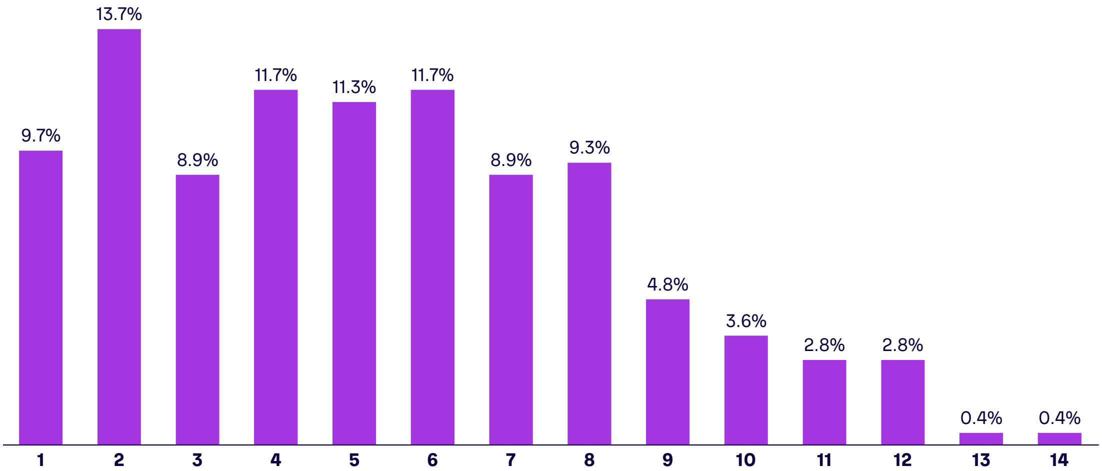

Figure 3. Average board size (number of directors), 2005–2023 (source: BoardEx)

CEO duality is not inherently bad. But boards must be deliberate about how they balance that structure. If your CEO is also chair, are there sufficient independent voices leading key committees? Are innovation efforts being discussed in spaces where genuine debate is possible?

Reflection 3: *If your CEO is also chair, who is leading your innovation-related committees? Do they have true independence?*

CEO duality boosts the likelihood of forming a strategy committee (perhaps to reinforce the CEO's vision), but it does little for forming other innovation-relevant committees (see Figure 4).

Tip 3: *If your CEO is also board chair, ensure committee leadership is intentionally balanced. Without counterweights, innovation oversight may skew strategic.*

3. THE HIDDEN COST OF BUSY DIRECTORS

The third major finding from our study speaks to a governance issue that many boards overlook: director busyness. A "busy board" refers to directors who serve on multiple boards simultaneously.[8,9] These directors often bring experience, connections, and credibility. But they also bring limited time and attention — two resources innovation governance can't do without. In other words, directors engaged in too many boards have limited time to contribute.

We found that busy boards are significantly less likely to form innovation and technology committees. In fact, the busyness of directors was one of the strongest negative predictors of committee formation in these areas.

Expertise without capacity is a risk. Many busy directors are appointed because of their industry knowledge or strategic background. But when they are stretched across three, four, five, or even six boards, their actual contributions to any one committee diminish.

This matters most in the context of innovation. Committee work in this domain is not passive.[10] It requires engagement with emerging trends, scrutiny of experimental initiatives, and the ability to ask informed, forward-looking questions. Directors who are overloaded lack the mental bandwidth to do this well. Boards can suffer from a kind of "credential trap" — assuming that prestige equals performance.

Boards should start looking not just at who is on their roster, but how available they are. It may be time to rethink director recruitment criteria to include both diversity of background and availability to engage deeply in committee work.

Reflection 4: *How many boards do your directors sit on? Are you (along with other board members) prioritizing prestige over participation?*

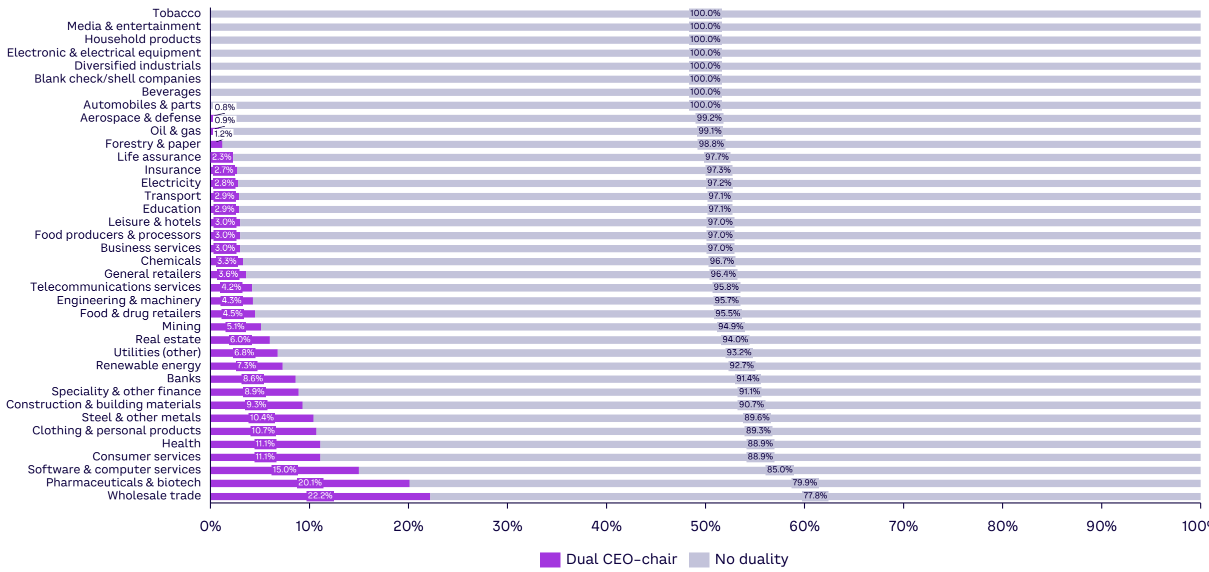

Figure 4. Average percent of CEO duality across industries, 2005–2023 (source: BoardEx)

It is tempting to fill boards with high-profile names. But our data shows that directors who sit on multiple boards are less likely to support innovation and technology committees (see Figure 5).

Tip 4: *Monitor your board's "busyness." Even the best minds cannot contribute if they are stretched too thin.*

PLAYBOOK FOR BOARDS THAT WANT TO INNOVATE

If there is one lesson to take away from our study, it's that innovation governance requires structural intention. Great boards are not just well composed, they are well organized. This shows up in how they form and operate their committees. Based on that, we propose the following four-step playbook for boards that want to govern innovation effectively.

STEP 1: ESTABLISH COMMITTEE(S)

Don't wait for an innovation crisis to form a technology or development committee. The most forward-thinking boards establish these structures proactively — before disruption hits. This allows the board to develop institutional fluency around emerging trends and support innovation long before it's urgent.

STEP 2: REASSESS CEO DUALITY

In boards where the CEO is also chair, it is essential that innovation-related committees be led by independent directors who are empowered to surface tensions, challenge assumptions, and guide experimentation. Innovation needs both alignment and challenge.

STEP 3: AUDIT DIRECTOR WORKLOADS

Avoid the temptation to overload innovation committees with prestigious leaders who don't have sufficient time to participate. Instead, assign members with capacity, curiosity, and courage, and make sure their work is meaningfully integrated into board deliberations.

STEP 4: SUPPORT SMALLER, FOCUSED COMMITTEES

Too often, committee formation is seen as compliance. But the best boards treat it as strategy. They ask: What does our committee structure say about our priorities? Where do we need deeper engagement? What signals are we sending to management and the market?

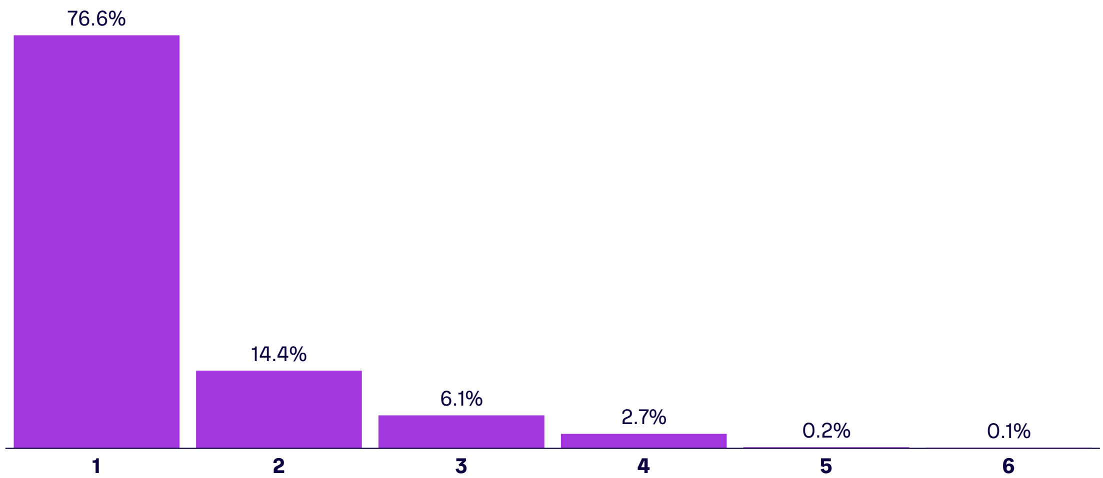

Figure 5. Average busyness of an individual director (number of board directorships), 2005–2023 (source: BoardEx)

CONCLUSION

Our findings about Brazilian companies suggest that the lessons learned may apply to other emerging economies, especially those where governance practices designed to leverage innovation performance are developing. This includes economies such as India, South Africa, Poland, and Hungary, as well as Latin American countries like Argentina, Colombia, and Mexico.

The innovation economy is not just changing products and services, it is changing how organizations must be governed. It demands faster cycles, deeper expertise, and more distributed decision-making. For boards, this means moving beyond the model of oversight as occasional supervision. It means building structures that engage with innovation directly.

Innovation does not thrive on vision statements alone. It needs risk committees that understand technology, development committees that support growth, and strategy committees that are not afraid of reinvention. All that begins with a single question: is your board built to innovate?

ACKNOWLEDGMENT

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About the authors

Filip Lestan is a PhD candidate at Nord Business School, Norway. His work bridges theory and practice, tackling such questions as: Why do firms innovate? How do they do it? What impact does it have? Mr. Lestan's research explores "stylized facts" of how CEOs, boards, and firm-level capabilities shape innovation in firms. In 2023, he was awarded an innovation fellowship by the Government Office of Slovakia, co-developing a national blueprint for living labs to boost Slovakia's competitiveness. As a member of the Expert Working Group of the Research and Innovation Authority under the Government Office of Slovakia, Mr. Lestan contributed to the national research and innovation strategy. He has held visiting positions at London Business School, UK; University of Pretoria, South Africa; and UNICAMP, Brazil. He can can be reached at filip.lestan@nord.no.

Ruy de Quadros Carvalho is Full Professor at UNICAMP, Brazil, and is one of Brazil's foremost experts in innovation management and policy. At UNICAMP, he leads the Technology and Innovation Management Laboratory (LABGETI) and founded the specialization course in strategic management of technological innovation. Dr. Carvalho also serves on the Scientific Council of the Instituto Eldorado and has held leadership roles at IPEA/Ministry of Planning. He is deeply engaged in research, teaching, and consulting on innovation strategy and technology management. Dr. Carvalho has been published widely in top-tier journals, such as *Research Policy* and *Technology Forecasting & Social Change*. He earned a PhD in development studies from the University of Sussex, UK. He can be reached at Ruyqc@ige.unicamp.br.

INSTITUTIONALIZING BOARD KNOWLEDGE

Author

Siah Hwee Ang

The board of directors is an important resource for executives, conveying experience from other industries along with valuable strategic and functional knowledge. Board meetings are the key mechanism for transferring this knowledge from the directors to the executive team. Unfortunately, infrequent board meetings (often with time restrictions) mean directors have become more of a sounding board for executives than a resource for deeper engagements.

Traditionally, directors were viewed as agents acting in the interest of shareholders. However, directors do not necessarily interact with shareholders, so a more realistic view of their role is as fiduciaries for an organization. Directors act in the best interests of an organization and its shareholders and are tasked with making discretionary decisions at times.[1]

Appointing a board is a crucial process for an organization. Directors are chosen in part for the resources, capabilities, and networks they bring. Although accessing these is part and parcel of engaging with directors, little attention has been placed on leveraging board knowledge and institutionalizing its knowledge base.

This negligence is a significant loss — and an opportunity. By making some relatively simple changes, board knowledge can be extracted and retained to enhance an organization.

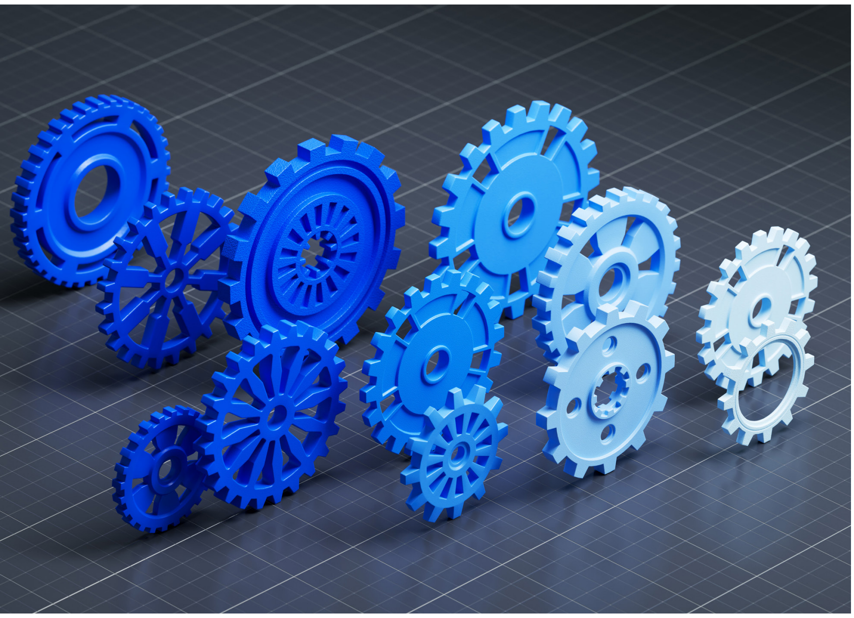
BOARD MODELS

There are four primarily board governance models; other models are mainly adaptations of the following:

1. **Anglo-American boards** — typically have eight to 12 members elected by shareholders. This model uses a one-tier system in which board members also sit on various subcommittees. It is commonly seen in the US and Commonwealth countries such as the UK, Canada, Australia, New Zealand, India, Malaysia, and Singapore.
2. **German boards** — usually two-tiered, with a supervisory board and a management board. Shareholders appoint the supervisory board, which then appoints the management board. As a result, German boards tend to be much larger than Anglo-American ones. Organizations in the Netherlands typically use a two-tiered system; in other European countries, organizations use either a one- or two-tiered board structure.
3. **Nordic boards** (largely adopted by Scandinavian countries) — similar to German boards in separating the board of directors and executives. However, Nordic boards are typically smaller, like Anglo-American boards. A special feature of the Nordic model is that the highest decision-making body is at the annual general meeting, where shareholders' voting rights are exercised, followed by the board and then the executives.
4. **Japanese boards** — typically consist of outside shareholders, government representatives, independent directors, executives, the bank, and keiretsu (a network of interconnected companies). Due to the number of groups involved, Japanese boards tend to be large. However, the introduction of the Stewardship Code in 2014 and the Corporate Governance Code in 2015 led to changes around corporate practices in Japan, helping boards become more manageable by allowing the nomination of more qualified board members that represent a wider group of stakeholders.

Some board structures affect the extent to which board knowledge can be institutionalized. For example, a one-tier system facilitates board knowledge exchange because board directors share their thoughts directly with the CEO and other leadership team members during meetings.

A two-tier system is slightly more complicated when it comes to knowledge exchange. Board knowledge is best tapped at the supervisory board level, and information flow between supervisory and management levels relies heavily on good communication channels and knowledge tracking at the supervisory level. Thus, successful institutionalization of board knowledge in a two-tier system requires extremely robust setup and coordination.



KNOWLEDGE LOSS

Knowledge loss is unavoidable, but measuring that loss to demonstrate the need for more preventive measures is difficult. Knowledge loss can only be assessed post hoc — its magnitude is virtually unknown until it's lost.[2] In addition to the usual suspects (loss of organizational memory and having to recruit), studies suggest knowledge loss can lead to social depletion as a result of damage to organizational partnerships, customers, and even remaining employees.[3]

Recent studies show there are ways to mitigate knowledge loss. For example, organizations can use knowledge management systems to take stock of various knowledge bases across the organization. Cross-pollination across divisions is also possible if there are mechanisms that allow knowledge sharing. Such systems can include proper documentation on best practices and past experiences, provided it can be integrated through work processes and routines.

In circumstances where attrition is likely, early planning on networking and succession development ensures that some knowledge can be extracted and preserved within the organization. Succession planning is not commonly done at a lower level in a larger organization, but knowledge retention is not just an issue for larger organizations. In fact, improper succession planning has been shown to cause significant problems in small and medium-sized enterprises.[4]

BOARD KNOWLEDGE

Significant research has been done on how succession planning affects the ongoing concern of an organization and what processes are needed for a smooth transition, but that planning rarely includes the board.

Directors typically spend years on the board and thus are well-informed about what is going on in the organization and its ecosystem (essentially, everything short of daily operations). In fact, very few executives have a comprehensive view of the organization as board directors. So it's not surprising that some organizations end up with a board member as their next CEO.[5] If board members make such good CEOs, it follows that executives should deeply appreciate the institutional knowledge board directors possess and work to leverage it.

The board chair plays an essential role in guaranteeing the board functions well during its limited time with the management team. In the case when the CEO is also the board chair, it's easier for the board and the management team to have seamless conversations.

However, in this scenario, it is important that the chair/CEO recognizes the governance role of the board and allows the board to do its job. In all cases, the chair of the board should refrain from dominating proceedings. Ideally, the board chair should take up about 10% of airtime in meetings.[6]

Director turnover is unavoidable, and refreshing the board is essential for bringing in new perspectives and innovation, as well as challenging the status quo. Recently, there have been concerns about a lack of turnover in boards, leading to sub-par performance. BlackRock, the world's largest asset manager, announced in its 2020 annual investment stewardship report that it cast more than 5,100 votes against company directors in the prior year for failing to hold company managers accountable for performance failures.[7]

BOARD COMPOSITION & DYNAMICS

Boards with diversity of experience can help organizations navigate increasingly challenging business environments, especially when it comes to cross-border engagements and international relations. Refreshing board composition to better deal with current issues is beneficial, but it is important that organizations not replace board directors "like-for-like" (i.e., with those of similar backgrounds and skill sets).[8]

For example, Admiral Group recently asked Paola Bonomo to join its board.[9] Admiral is a large financial services company offering insurance and personal lending products. It is headquartered in the UK and has offices in Canada, France, Gibraltar, India, Italy, Spain, and the US. According to the chairperson of Admiral's board, Bonomo was appointed because of her deep knowledge of the international financial services sector and extensive experience in digital transformation. Existing board members have some overlapping experience with Bonomo, but she brings new insights from current and previous management and board experience that are desirable for Admiral as it looks to expand internationally.

Director tenure is another important factor. Longer tenures generate familiarity with the organization that can foster deeper conversations. For example, David Deed retired from LCI Industries's board after serving as its director for 22 years.[10] However, as an organization's circumstances and environments change, injection of new blood to the board is likely to be more productive. Research shows that organizations that replaced three or four directors over a three-year period outperformed those who had fewer or more board turnovers in the same period.[11]

There is a misperception that boards should only be highly involved in management matters when an organization is underperforming. Actually, this approach leads to a lower likelihood of previous board members staying in touch, resulting in institutional knowledge and network loss. One way to alleviate this is to stagger directors' terms, so less than half of the board has tenure that expires at the same time.

It is important to note that increasing the size of the board does not necessarily add more knowledge, as board knowledge can only be accumulated when all directors are given adequate time to share their knowledge. Given limited time for board discussions, board composition must be well thought out to allow maximum utility of board advice and knowledge sharing.

For example, although most directors conduct work in just one industry, some are familiar with more than one due to previous work experience, directorships on other boards, or consultancy/advisory roles, and many directors possess multiple disciplinary skill sets.

It's also important to consider the midterm future and beyond when selecting directors. A few years ago, knowledge about areas like AI, robotics, sustainable energy, blurring industry boundaries, geopolitical risks, and employee health and well-being might not have ranked high on a list of desired knowledge for directors.

Beyond addressing knowledge gaps, organizations should consider the soft skills board directors possess. Ideally, board directors will have (1) an ability to be objective, (2) an ability to comprehend the issues at hand, (3) an ability to devote the requisite time and attention, and (4) an eagerness to exert themselves on behalf of shareholders.[12] These aspects of board wisdom cannot easily be institutionalized, but they can be ascertained by executives through proper due diligence.

MECHANISMS TO INSTITUTIONALIZE BOARD KNOWLEDGE

Board directors have traditionally been treated as a governance body formed to monitor operations and provide advice to management. A better approach involves tapping into the wealth of knowledge directors possess and — acknowledging that their tenure is often much shorter than that of a senior executive — working to capture their hard and soft skills in a way that permits long-term access.

For example, board directors and an organization's management team often have little contact outside of board meetings. This is sometimes culturally driven and sometimes just reflects board directors' busy schedules. As a result, most directors serve as agents rather than fiduciaries for an organization and its shareholders. To address this, the board chair and CEO (if not the same person) should meet before and after board meetings to work on agendas, discuss follow-ups, talk through issues, and consider opportunities. This process can be expanded to involve subcommittees within a board. Getting a board more involved is one simple way to get it to impart more knowledge (especially tacit knowledge) to the management team.

More frequent interactions may also be possible, depending on how close the board feels it is to the management team or the CEO. Recognizing the board's fiduciary role, the management team should work to stay more connected, perhaps inviting the board to the organization's business and social events and functions. This helps the board get to know the organization, management team, and stakeholders better to facilitate knowledge sharing.

Other than seeking advice and ensuring it meets the board's expectations, the management team should seek connections through its boards. Board directors are business and (perhaps) government representatives in their own right, and many sit on multiple boards. Connecting to board directors' networks can enhance the management team's appreciation of the wider business environment and increase access to potential resources and partnerships. Building this type of connectivity widens the organization's circle of influence and is a major step toward the institutionalization of board knowledge.

The hard skills (technical knowledge and abilities essential for performing a particular job or role) of board directors can often be institutionalized through a staggered approach to board succession. Staggered recruitment and replacement regimes ensure these institutionalized hard skills are retained.

Soft skills (abilities around teamwork, communication, problem-solving, adaptability, emotional intelligence, time management, and leadership) require a different approach. These abilities are embedded within individuals and only surface when board directors share their experiences during board discussions and decision-making processes. Extracting this knowledge relies on interactions with board directors. From an organization-level perspective, this means interacting as groups and documenting discussions to show how boards arrived at decisions.

Organizations should get their boards more involved in strategic discussions — this should not be confined to an annual strategy planning session. Business environments are constantly evolving, so it makes no sense for strategic discussions to take place only once a year. Instead, companies should seek more frequent and deeper conversations with the board about how the organization should look in the near term, the midterm, and further out, including not just challenges but opportunities.

These recommendations are not an exhaustive list of how to maximize and institutionalize board directors' knowledge, but they are good starting points. Some will work better for your board structure and company culture than others.

Of course, organizations should seek other ways to institutionalize board knowledge that work for both the management team and board directors. Recognizing that board knowledge is a valuable resource that can be institutionalized through relatively simple mechanisms is critical.

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About the author

Siah Hwee Ang is Professor in Strategy and International Business and Chair in Business in Asia at the School of Marketing and International Business at Victoria University of Wellington (VUW), New Zealand. His expertise focuses on the connection between strategy, business, and trade. Dr. Ang has been published in various journals, including *Strategic Management Journal, Journal of Management, Journal of World Business, Journal of Management Studies, Journal of Business Research, Management International Review, Long Range Planning*, and *International Journal of Human Resource Management*, and his work has led to five research awards. Dr. Ang is Senior Editor at *Journal of World Business,* Deputy Editor-in-Chief at *Asia Pacific Journal of Management*, and a member of the OECD's Entrepreneurship Education Collaboration and Engagement Committee. He is also president of the Wellington Chamber of Commerce, board member of Business Central New Zealand, and former board member of the ASEAN NZ Business Council. Before joining VUW, Dr. Ang was Professor and Associate Dean at the University of Auckland Business School, New Zealand, and worked at City St George's, University of London, UK, and the National University of Singapore (NUS). He is Visiting Professor at several Asian universities and is frequently featured in the media as an expert on Asia and international trade matters. Dr. Ang earned his PhD in management from NUS. He can be reached at siahhwee.ang@vuw.ac.nz.

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