

Industry expertise on the board

Position paper

Norges Bank Investment Management position

1. The board should collectively have a thorough understanding of the industry in which the company operates. A majority of independent board members should have fundamental industry insight.
2. The board should have sufficient industry expertise to monitor management's implementation of corporate strategy. At least two of the independent members should have worked in the industry.
3. The board should have an effective nomination process to identify suitable candidates with industry expertise and provide an explanation to shareholders of the relevance of their qualifications.

Background

The board is responsible for guiding company strategy, monitoring management performance and providing accountability to shareholders. Ensuring that the board functions effectively is of fundamental importance to shareholders. This position paper considers the importance of industry expertise for the effective functioning of the board.

Industry expertise can be understood as specific knowledge that provides in-depth understanding of business drivers. This includes both experience from working in the industry and fundamental industry insight gained from other roles.

As a global investor, we observe different emphasis on industry expertise across companies. Best-practice codes provide limited guidance, except in the financial sector where experience from the financial crisis has led to a focus on financial expertise on the board, which in some markets is reflected in regulation.

Arguments for the position

The board must know the industry to guide company strategy

Each industry has its own drivers of opportunity, risk and profitability. A board with independent members who have in-depth knowledge of the relevant drivers will in most cases be better qualified to set strategic direction.

Independence must be informed to be effective

Monitoring the implementation of company strategy requires objective and independent judgement. With industry experience, independent board members will be in a stronger position to form their own opinions, and to support and challenge management as needed.

Industry expertise can strengthen value creation

A board with strong industry expertise will have a deeper understanding of the business and will therefore be able to devote more attention to company activities that add profitability, reduce risk and promote growth.

Arguments against the position

Similar expertise leads to group thinking and inertia

Industry experts are not always able to see intrinsic problems independently from management, especially in periods of fundamental industry change when the company's business model is at stake.

Competing expertise will undermine the role of management

Competing industry expertise on the board can lead to directors second-guessing management's analysis and recommendations. This may create uncertainty about roles and responsibility and undermine accountability.

Industry expertise crowds out other considerations

Where industry expertise is scarce, securing industry expertise on the board may create conflicts of interest. In addition, some industries have few comparable companies. Industry expertise is only one of many aspects that the nomination process must consider, including the need for diversity.

Norges Bank Investment Management considerations

Weighing the arguments, we find that industry expertise is a key requirement for the board to be able to fulfil its responsibilities. Shareholders have an obvious interest in boards whose members thoroughly understand the industry in which the company operates. Such a board will have a better understanding of the company's business and its risks, its main competitors and the trends that will shape the industry. This will in turn strengthen the company's ability to create long-term value.

We recognise that there is no easy way of defining industry expertise. Balancing competing considerations and identifying relevant candidates are true challenges in the nomination process. Industry expertise is hard to define with formal criteria and must be assessed in light of company circumstances. We encourage the company's board or nominating body carefully to consider criteria for industry expertise, prioritise relevant qualifications throughout the nomination process, and explain its reasoning to shareholders.

We believe that a mix of direct experience from working in the industry and fundamental industry insight gained from other positions will significantly strengthen long-term value creation. We are concerned that the absence of industry expertise may be an indication that the board is not able to guide company strategy or monitor management effectively, and that the board nomination process has not been effective in identifying relevant candidates.

This position will serve as a basis for our discussions with company boards.