Building Better Boards: Taking the Long View of Director Succession

Russell Reynolds ASSOCIATES

The Long View of Director Succession

When it comes time to fill an open spot on the board of directors, it's far too easy—and far too common—for directors to fall into the trap of short-term planning and "who do we know" candidate identification.

In recent years, companies have improved with regard to thoughtfully identifying and recruiting senior leaders who are best positioned for long-term success in the organization. Now, the same transition is taking place in the boardroom. Director searches now often involve a candid analysis of the board's current composition, identifying future needs and developing a long-term strategy for board recruitment.

Boards that have successfully managed the refreshment process typically start with a board composition analysis, a strategic planning process that is comprised of four primary activities led by the Nominating and Governance Committee (NomCo):

1

UNDERSTAND THE STRATEGY

The first, foundational act is for the NomCo to leverage its understanding of the company's emerging strategy and related organizational changes, as they will play out over the next three to five years. This will provide the essential context for the board composition analysis.

2

AGREE ON THE SKILLS AND EXPERIENCES REQUIRED

If the committee has a sense of the direction of travel for the company, it will be easier to decide who needs to be on the bus (to invert Jim Collins' famous edict1). Thus the second phase focuses on developing a clear and agreed-upon set of definitions for the key skills and experiences that will be needed at the board level and for the committee to take a hardheaded look at each director's skills and experiences against those definitions.

3

CREATE CONSENSUS ON FUTURE PLANS

The third phase is to work with each director and review the matrix with them. It is important that everyone feels the process has been fair and transparent. The committee also needs to explicitly ask each director about their personal plans vis-à-vis the board for the same three-to-five-year period (all other factors being equal). An accurate forecast of when vacancies may occur is essential, though the committee may also need to make tough decisions to create vacancies in order to refresh the board.

4

CONSIDER WHAT TO DISCLOSE

Investors are seeking more information in an easily digestible format to enable them to understand how your board composition links to the company's strategy. Having completed the prior steps, board leaders and the legal team can determine what can be disclosed to investors about the process, current board composition and decisions about future recruiting.

1. "The executives who ignited the transformations from good to great did not first figure out where to drive the bus and then get people to take it there. No, they first got the right people on the bus (and the wrong people off the bus) and then figured out where to drive it." Jim Collins. Good to Great: Why Some Companies Make the Leap … and Others Don't. New York: HarperCollins, 2001.

The Wrong Way to Do the Right Thing

As beneficial as long-term board succession planning can be, there are numerous ways that it can be done badly to the ultimate detriment of the board, the company and its shareholders. We have seen four common errors that derail the work:

1 PUTTING STRATEGY SECOND

We often see boards undertake these efforts without explicitly connecting them to the overall corporate strategy. If you are a traditional financial services firm that is looking to digitally transform, and you don't take that into consideration, then the board is undertaking a meaningless exercise. It is critical to think about where the company is going, what the board will need to look like in the near future and what type of directors will need to be a part of it. Plan for where you know you're going, not where you currently are or have been.

2 IGNORING THE COMPETITION

Boards often fail to benchmark themselves against their peer group, yet when analyzing corporate governance practices, investors often look at entire sectors at a time. If you are an automotive company, and every other board has recently added an expert in self-driving cars and you have not, investors may well have questions about your approach.

3 ASSUMING IT'S ALL ABOUT JOINERS, NOT LEAVERS

One element of board composition analysis is the timing of when new directors join, and it is important to take into consideration anticipated retirements. Movement of directors is a natural occurrence—whether due to age or tenure limits, overboarding or individual director desires and life changes. We have seen too many occasions when these changes were known ahead of time by directors but not shared with the NomCo. And the NomCo was complicit because they never asked the question.

4 FORGETTING ABOUT BOARD AND COMMITTEE LEADERSHIP AND MEMBER ROTATION

While few boards have policies to limit the tenure of lead directors and other key roles or committee memberships, it is important to understand the impact of retirements and new joiners on the composition of committees. The leadership of committees and the board itself should be part of the three-to-five-year plan.

Once the board begins the process of undertaking a composition analysis, it is important that it is an open, inclusive process involving every single director. This can't simply be managed by the general counsel or another executive from afar. Everyone has to have buy-in to the process and analysis.

At the same time, it's important not to allow directors to over-inflate their qualifications. Directors will often believe that they are more current on a topic than they really are or that CFO experiences twenty years ago put them on the same level as someone who is an active CFO today. To avoid this, there needs to be a clear set of criteria for every measure, and the NomCo needs to be the ultimate arbitrator on ratings and qualifications.

Lastly, and perhaps most importantly, boards can't avoid hard conversations during this process. Some of today's directors won't have an obvious role on tomorrow's board, and others may believe they have qualifications or relevance that they don't truly hold. The board leader (non-executive chair or lead director) or NomCo chair needs to be willing to sit down and have an open, honest and direct conversation with each board member during this process, including a willingness to help some directors find their way off the board.

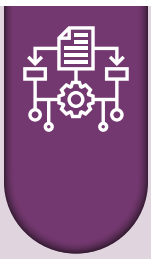
While the board has to own the process and the results, using a third-party advisor can help deal with some of the challenges involved. One benefit is that they can help ensure there is the required objectivity and rigor in the process.

The Benefits of Action

A rigorous board composition analysis creates value in numerous ways:

IT ENABLES THE BOARD TO SET ITSELF UP FOR LONG-TERM STABILITY AND SUCCESS

A well-run board succession effort enables long-term planning and prevents a transactional approach to director recruitment. Similarly, it enables thoughtful board rotation, including for committee chairs and the board leader, and therefore could be used to improve diversity efforts in board leadership roles. At present, 92 percent of board leaders in the S&P 500 are men, as are 78 percent of committee chairs.



IT GIVES THE NOMCO CHAIR A NEUTRAL, DATA-BASED TOOL FOR ADDRESSING INDIVIDUAL CONTRIBUTIONS TO THE BOARD

It's difficult for any chair to sit down and address issues of personal contribution with a fellow director, but a board composition analysis creates tools and opportunity to have a more neutral, fact-based discussion about skills and qualifications and to start a conversation about director offboarding. Likewise, it can provide a foundation for talking about director retirement, leadership changes and committee rotation—all things a healthy, well-performing board ought to address.

IT CAN BE LINKED TO CORPORATE STRATEGY AND COMMUNICATED TO OUTSIDE STAKEHOLDERS

A rigorous board composition analysis is further evidence that a board is taking its responsibilities seriously, is thinking about the future of the company and is prepared to help steward the organization over the long term. The board, if it so chooses, can disclose the analysis to outside investors. In 2018, 30 percent of S&P 500 and 13 percent of Russell 3000 companies published a skill matrix in their proxy statement, a twofold increase in both indexes from 2016.[2]

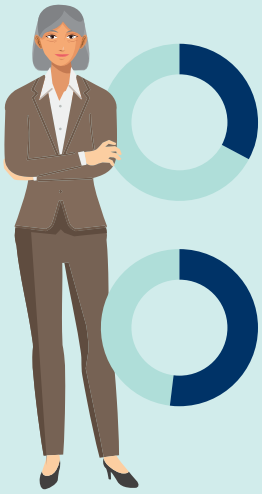
Thoughtful succession planning is critical to a healthy board. Although it must be championed by the independent board leadership, outside advisors can help or even lead the effort. But it is ultimately up to the entire board to thoughtfully engage in the process and be open to the conversations that follow.

2. Rusty O'Kelley, Anthony Goodman, Justus O'Brien, and PJ Neal. *What the Board Wants to Know: Answers to 12 Common Questions*. Russell Reynolds Associates: New York, 2019. https://www.russellreynolds.com/insights/thought-leadership/what-the-board-wants-to-know-answers-to-12-common-questions.

Why boards need to be more strategic in their approach to director recruitment and tenure management

20% of the firms in the **Russell 3000** have **no female representative** on their board of directors.

Fewer than **2 in 10 board committee chairs at S&P 500 companies are women,** and the share is even lower among smaller firms in the **Russell 3000**



33% of the **Russell 3000**

AND

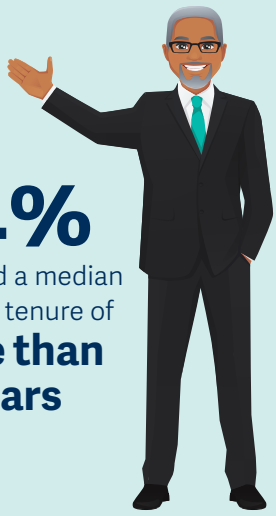
52% of **S&P 500 companies**

consider **gender diversity** as part of their process for assessing director candidates.

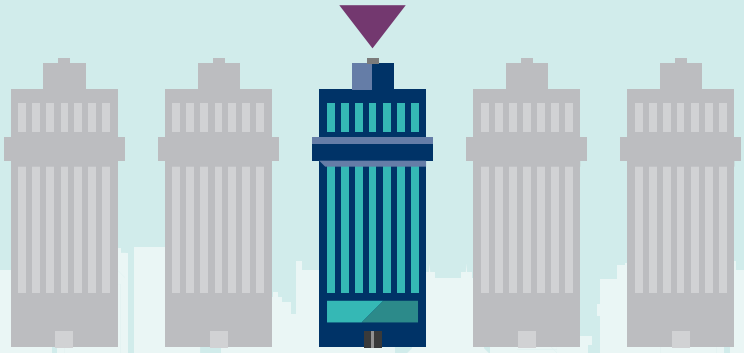
Tenure

36% of **Russell 3000** had a median director tenure of **less than 6 years**

24% reported a median director tenure of **more than 15 years**

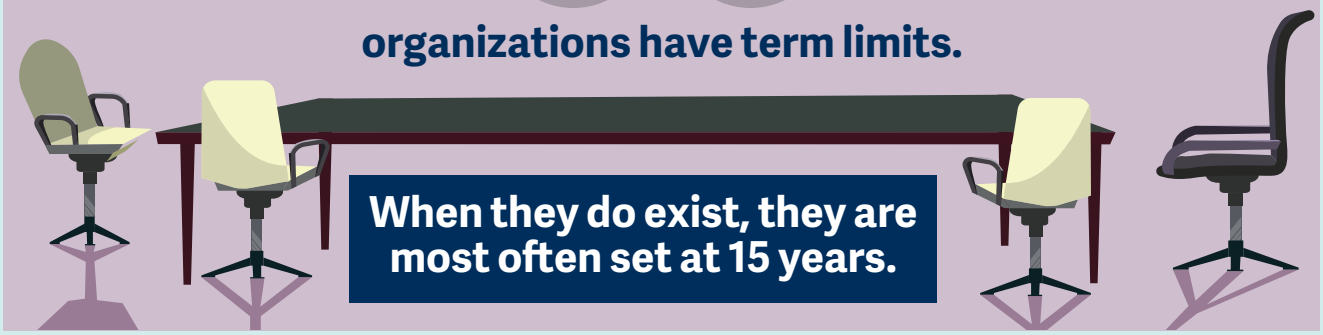


About
1 in 5
companies
elected one first-time director
to their board in 2018,
while only 4% elected two



Only **5%** of **S&P 500** and **3%** of **Russell 3000**

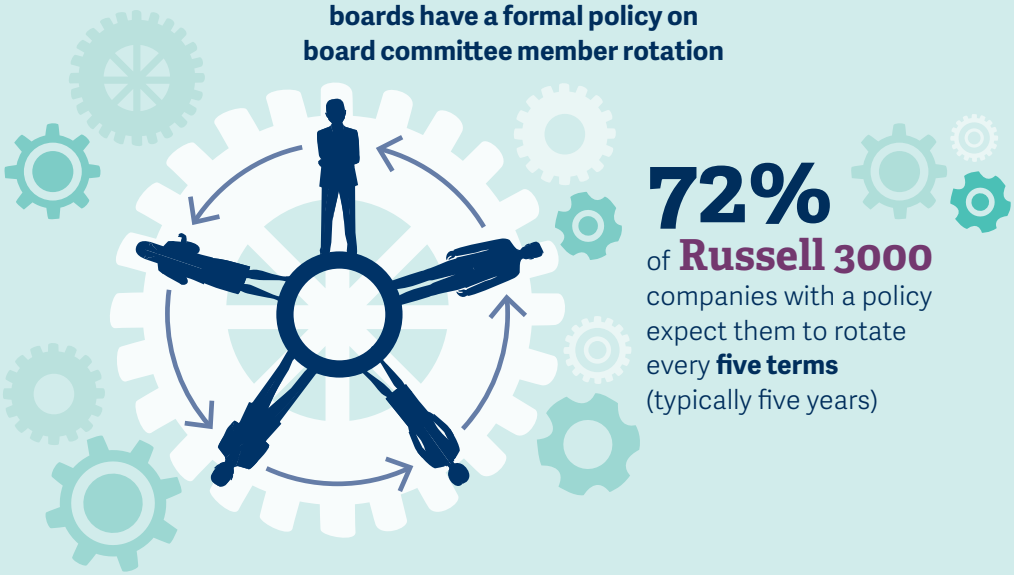
organizations have term limits.



When they do exist, they are most often set at 15 years.

21% of **S&P 500** AND **13%** of **Russell 3000**

boards have a formal policy on board committee member rotation



72% of **Russell 3000** companies with a policy expect them to rotate every **five terms** (typically five years)

AUTHORS

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