EgonZehnder

It's Time for Boards to Take Time for Themselves and Practice What They Preach

Spurred by dramatic changes in the global economy, shifts in strategy, declining CEO tenure, and the demands of shareholders, boards have finally gotten the message about CEO succession. Boards are now far better prepared for a range of events that may necessitate a new CEO – from planned retirement, to illness, to public scandal – and shareholders are more secure as a result.

But when it comes to planning for their own succession, boards continue to go without, neglecting to apply to the board all that they have learned regarding CEO succession.

Why the disconnect? Boards are too nice, too passive/aggressive, and fearful of having a straightforward conversation. Directors often cite reasons such as the desire to preserve the "culture" or the "relationships" of the board or to protect someone's feelings. The upshot, though, is that boards often default to age limits as the mechanism to bring new talent to the board. That means they lack the resources they require to accomplish their work, and that is not in the company's best interest.

Boards that are driven more by the "stick" than the "carrot" are especially disconnected. These boards typically engage in board assessments because they are compulsory, not because they are motivated to build the best, most effective board possible. They lack a common understanding of the need to regularly update and upgrade skills on the board, and instill in their directors a sense that they serve in perpetuity. It is crucial to recognize that board succession is inextricably linked to effectiveness reviews – ideally for individual directors and the board as a team – because a board can only determine the skills and experience needed after taking stock of what it already has.

We often meet with directors who express the need for new expertise in the boardroom. Currently, the greatest demand is for directors with digital, risk management, compensation, and emerging market experience, or those who contribute to diversity, though there are many other criteria depending on the needs of the specific company. At the same time individual boards recognize the need to add new skills, boards in general have pared down significantly in size. In fact, we often hear directors say that they would like to add directors with new skills, but maintain the same board size, or even shrink.

Simple logic suggests that someone has got to go, and that is the root of the problem. Call it the job no one wants: telling a director he or she is no longer relevant or necessary or, worse, not performing to an expected standard. Often the CEO is the unlucky messenger, effectively having to fire one of his or her "bosses." Rather than meet the problem head on, boards avoid any unpleasantness by waiting for age limits or change of control to kick in and do the deed for them. But this means both time and opportunity lost while boards do without the skills they need.

More systematic, less personal

While there are often underperforming directors who need to be replaced, boards are just as likely to have outgrown certain directors. That is frequently the case when there is a significant change in the strategy – a new market or product, for example – and no one on the board with relevant skills.

The best boards now rely on the company's strategy to guide the board review and recruitment process. This is the flip side of the old CEO/director networking process, where directors were hired less for specific skills and experiences and more for relationships with the CEO or others on the board, or the myopic, spottrade, where boards need to fill a director's seat and consider who is available at a given time. One shortcoming of this approach is that it is hard to identify emerging talent this way, since the focus is only on higher visibility talent available at any given time.

Strategic recruiting entails viewing the board's needs from a more comprehensive team perspective, taking stock of all of the board's skills, as defined by the strategy, and noting what gaps need to be filled. Boards should not make the mistake of stuffing too many requirements into any one recruitment or they many end up with the elusive "unicorn spec"; when too many attributes are sought in one director candidate, boards are likely to come up empty handed in their search. It's the team as a whole, not individual directors, that constitutes the critical resources of the board.

Recruiting new directors, as we have mentioned often means shedding old ones. Of course no one wants to be told that he or she is no longer of value, and certainly no CEO or board chair wants to be the bearer of such news. But boards owe it to their companies and their shareholders to maintain a cohesive board that reflects the strategic direction and provides support and counsel to the CEO and the executive team as they execute the strategy.

How do boards get there? Relying on a regular, predictable director and team effectiveness review built on recognized best governance practices is the best way to take pressure off the CEO. The first step is for directors to embrace the concept that boards, like their strategy, grow and morph as the world around them changes. And that serving as a director does not mean one is a lifetime appointee.

Inherent in the review process is an understanding of what "good" looks like when it comes to governance, and that begs the question, compared to what? On a fundamental level, directors are expected to be wise and thoughtful counselors and partners to the CEO. A key element of that relationship is constructive tension, where directors freely question, and openly discuss the strategy on which business plans are based. Good directors are team players – with the CEO and other directors – but unafraid to challenge; are financially literate; and possess a high level of business acumen, particularly with rapidly shifting business environments. Directors must be committed to fully engaging with the board, assuming leadership responsibilities as required, and accepting the fiduciary and leadership succession responsibilities associated with the role. Directors are also expected to willingly contribute their specific skills and expertise and leverage their personal networks as needed.

Drilling down beneath this general level, each board will have to determine the specific competencies they require in directors, based on their business and strategy, evaluate where strengths and weaknesses lie, and decide what should be done to address areas where directors fall short. Board assessments are not an end in themselves. The overarching goal – as with any team – is to improve the performance of the individuals who comprise the team as well as the performance of the team as a whole. Required competencies will vary board to board, but may include such criteria as knowledge of the strategy, knowledge of the specific industry, knowledge of governance requirements and trends, as well as those related to individual director performance in the boardroom.

Boards should also consider an experienced, objective third party to lead the review process. Decisions based on a clear strategy and concrete, agreed-on objectives are far easier to accept and implement than those perceived as driven by personal agendas and board politics. An externally facilitated board effectiveness review is often the most comfortable and effective way to get 360-degree feedback on each director. This provides the board leader with the necessary data on director performance to reinforce the contributions of high-performing directors as well as to discuss an improvement plan with directors who are not performing well on one or more dimensions. Ultimately, the data may be used to terminate a director who continues to fall below an acceptable level regarding critical criteria.

Maintaining the essential resource a high-performing board represents is real and ongoing work, but the investment is worthwhile. The minimal approach of some boards – ticking off the boxes in an annual board self-assessment exercise just to be able to say it was done – is not an effective or efficient use of the board's time. Regardless of whom the board partners with to lead the process, it must be owned by the board.

Getting the board on board

Succession planning for boards is not a mysterious process; it closely mirrors the CEO succession process, with which boards have gained significant experience in recent years. It is important to recognize that each board has a unique culture and to tailor the process accordingly. Ultimately, success in board succession hinges on getting the board engaged in designing a solution and following through, on a regular basis, to ensure the board has the optimal mix of skills as needs change over time.

Here are some suggestions on how to get started:

Create a vision – Perhaps as part of a regular strategy off-site, plan a session for directors to discuss the related topic of the future of the board: What is called for in the strategy that is currently missing a complement on the board? Think in terms of specific competencies needed in directors.

Design a process – Who on the board will lead the process? What will the process entail for the board as a whole and for individual directors? What will the frequency be? While some boards do the minimum required to meet regulatory requirements, others are finding that investing time and resources in an in-depth review generates critical insights, builds teamwork and the ability of the board to engage effectively with the CEO, and quantifies the competencies required for success. Many leading boards undertake an independent assessment by an objective third party every two to three years.

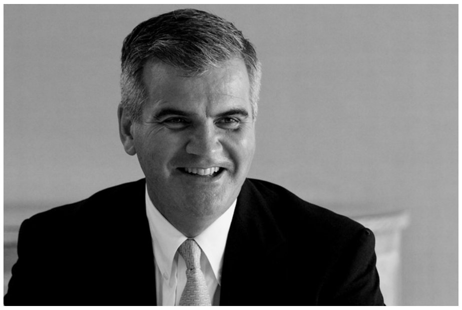
Determine ground rules – How will information gathered from reviews for board succession planning be shared? What will be the process for replacing directors deemed underperformers or simply no longer relevant to the strategy? Agreeing on what the rules will be and that they will apply equally to everyone will help to reassure everyone on the board of the inherent objectivity and fairness of the process. Be confident and bold rather than shying away from the challenges.

Get board buy-in – Directors should have an opportunity to express their views on different approaches to board succession planning and then come to an agreement as a team on the process they will implement to ensure their skills and experience remain fresh and aligned with the strategy.

Rinse and repeat – Recognize that the real value from board succession planning, which translates into greater effectiveness, emerges from a commitment to ongoing reviews. Instill good habits by tying board succession to a regular event, carving out dedicated time at a strategy offsite, for example. Linking board succession to the strategy – as CEO succession now is – drives home the message that boards do not exist in a vacuum and composition is not arbitrary.
There is no reason for the board to take a back seat when it comes to succession planning. Directors have now had a good deal of experience in the parallel process of CEO succession planning, and we know from our conversations with directors and CEOs that they appreciate the value of board succession planning.

It is the culture of politeness in the boardroom and the desire to avoid confrontation that have been the chief stumbling blocks to implementing board succession planning. The mistake many boards make is to think that providing directors with direct and honest feedback will damage boardroom culture, when the real danger is not surfacing issues and addressing how they can be fixed. While it is true that board succession planning often involves replacing less relevant or underperforming directors, sometimes a periodic review does not reveal that change is needed. Boards nonetheless find this regular dialogue a healthy exercise, as well as an excellent way to keep an eye on the emerging needs of the board and the talent that may be required in the future. When a review becomes part of the board's regular routine, it is not only more effective but more comfortable for all concerned.

It is time for directors to step up, let the CEO off the hook, and build a succession culture based on objective analysis and planning, to ensure boards have the directors they need. Getting started – especially since it may require a culture change – may be the hardest part for some boards. But directors know it is the right thing to do: for the board and, more important, for the company and its shareholders.



George L. Davis
Co-leader Global Board Practice
Egon Zehnder International
george.davis@egonzehnder.com
1 (617) 535-3570