boardroom conversations

Strategic Board Succession Planning Comes Of Age

Board Succession Planning Is No Longer About Filling An Empty Seat — It Is About Fulfilling A Vision.

In the past, boards treated board succession tactically, appointing the most eminent available candidate or someone who could meet an immediate need. Today, however, both external and internal pressures are compelling directors to adopt a longer-term, strategic view of the composition and evolution of their boards. But taking that long-term view is only the first step. Boards must also adopt practices that make the vision a reality.

EgonZehnder

Over nearly two decades of heightened attention to good corporate governance, widespread agreement has emerged about what the approach to board composition and succession should look like at a high level: Assess current and future board requirements in terms of the operational and strategic direction of the company. Factor in the evolving competitive environment within the industry as well as large-scale changes like globalization, technological transformation and sustainability. Then make sure the board is composed of directors who offer the right mix of skills, experiences and perspectives to provide oversight and advise the CEO under those conditions.

But when this ideal collides with reality, big-picture strategic thinking can end up taking a back seat to immediate pragmatism. To be sure, most companies take a more rigorous approach to identifying and nominating director candidates than in the past, reaching beyond their personal networks to screen a larger candidate pool against an objective profile of the board's and the company's strategic needs. But even with these improvements, most companies do not approach director succession planning with the same long-term view that they take with CEO succession. It can still be too easy to view director succession as filling vacancies rather than constructing a board.

If there is broad agreement that having the right board composition is an important corporate asset, why are the necessary best practices so difficult to implement? In our view, a major impediment to strategic thinking in board composition can be found in the structure of the board nomination process itself. Boards, given their mandate to protect the long-term interests of shareholders, de facto seek continuity. So it is that individual board seats turn over only rarely—about once every 12 years, on average. In addition, many boards that have retirement guidelines have pushed the age of retirement up in recent years—in some cases to 75 years. As a result, many more years may pass between vacancies, with none of the regularity and rhythm of other business processes. Not only does this make it difficult to act strategically regarding board nominations, but it also makes it possible for the board to become dangerously out of sync with the organization's business strategy and operating environment.

Pressures — and Opportunities — to be Strategic

Today, however, a number of powerful currents have come together to give new urgency to issues of board composition and strategic board succession planning. Among the most prominent developments are the following:

Fierce competition for the best director talent. Certain skills and experiences are in high demand, such as directors who have firsthand experience helping to oversee or manage technological transformation within an organization. The sensitivity to "overboarding" and the wariness with which many sitting executives—and CEOs in particular—regard the extra workload from sitting on an outside board means stiff competition for the most qualified directors.

A world in flux — and winner-take-all rewards for those who navigate it best. Today's economy is defined by evaporating boundaries between geographic regions, distribution channels and business functions. New technologies are lowering barriers to entry not just in knowledge-intensive industries, but in more tangible ones, like manufacturing. In addition to these promising developments, the recovery from the 2008 global financial crisis continues to be uneven. Companies who can move decisively to identify and dominate new markets can relatively quickly gain momentum that will be difficult for competitors to derail. The right board can play a critical role in advising a management team undergoing such a transition.

A persistent "global capability gap". As U.S. economic growth slowed in the last half-dozen years, companies across the country successfully pursued or created new growth opportunities overseas. Nearly three-quarters (72 percent) of all S&P 500 companies now report some amount of international revenue, which now averages 37 percent of total revenue. For many U.S.-based companies, however, board composition does not reflect this new reality.

This disparity between a company's global footprint and the ability of its board to guide and advise leaders on global matters creates a global capability gap. Not surprisingly, companies with global expertise in the boardroom have a better understanding of the revenue volatility associated with global expansion and are better able to exploit the upside and minimize the downside of operating overseas. While our research shows that the share of S&P 500 directors with international work experience now stands at 14 percent, up from 8 percent in 2008, there is still significant room for improvement—even at those companies that have enhanced their global boardroom capability.

Looming multiple retirements. The median age of directors continues to rise each year, and while many boards have raised the retirement age, many directors remain at or very close to their board's recommended or mandatory retirement age, creating the prospect of multiple vacancies—two or more within a one– to two–year window.

A broader notion of diversity. The idea of diversity has evolved from familiar categories of race and gender to the broader notion of diversity of perspective. Its business value derives from the fact that diverse boards (and management teams) have a wider range of skills and competencies, industry and functional expertise and cultural perspectives, and also bring a greater degree of global business experience. This breadth of attributes is a wellspring of innovation and serves as an invaluable check and balance in group decision-making. But this more sophisticated understanding of effective board composition requires an articulated strategy and a much higher degree of coordination and planning for director succession.

Greater regulatory scrutiny of board composition as a corporate governance function. Investors, regulators and other observers are focusing greater attention on corporate governance issues such as director independence and succession. Board composition has begun to appear on the radar screen as well. Investors now consider board composition and tenure to be a litmus test for a company's governance capabilities. The SEC's 2010 proxy disclosure rules regarding director selection requires "companies to disclose for each director and any nominee for director the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director for the company." The new disclosure was required for all nominees and for all directors, including those not up for nomination in a particular year. Why all? "Because," said the SEC, "the composition of the entire board is important information for voting decisions."

Emerging Best Practices

The most forward-looking boards are using these developments as impetus for a holistic reexamination of their board succession planning process. From our work with these boards, we have distilled a number of best practices, the most critical of which include the following:

Step up the rigor of board evaluation. While not new in concept, annual board evaluations have recently come into the spotlight, and for good reason. Although historically helpful in assessing the general health of the board's processes, culture and the capability of the overall board, they often lack the thoroughness, specificity and transparency now expected by stakeholders. In addition, if boards self-assess, the evaluations often lack true objectivity. As a result, we are seeing a trend toward institutional investors requesting disclosure of process in the proxy statement and demanding objective, third-party board evaluations. This increased scrutiny of the assessment methodology by shareholders, activists and regulators will necessarily raise the critical level of board evaluations – with the benefit of making them even more effective in the succession planning process.

Define the spec via a more dynamic board matrix. Today's board matrix is usually a static summary, used tactically. Instead, insights into the future corporate strategy plus director retirements and committee rotations should be the basis for developing a more purposeful matrix that functions as a forward-looking tool to analyze anticipated multi-year vacancies and capability gaps. This should then be translated into a spec that comprehensively articulates the dynamics of both near and longer-term needs.

Marry multi-year strategy with opportunity. Forward-looking perspective keeps the focus where it belongs: on overall composition and evolving needs, rather than on a particular opening. And in cases where several vacancies may be looming within a few years of each other, it can foster a marriage of strategy and opportunity. For example, instead of filling these needs in a prescribed order, the board would seek the best candidate available at the time to fill one of the future vacancies. A second vacancy would be filled by the best candidate available at the time against remaining areas of need, and so on.

Maintain an "evergreen" picture of the candidate pool and cultivate potential candidates far in advance. Having established a clear picture of the skills and expertise the board will need and when it will need them, for future needs the board should begin to develop relationships with potential candidates well in advance. This widens the talent pool to include high potential candidates who are not quite ready, or executives who cannot serve now but who will be available in the future. This puts the board ahead of the game in the war for boardroom talent, with an equally important side benefit being the board's ability to use this time to get to know potential candidates well before they join, which helps with onboarding and acclimation of new directors.

Establish a process with clear roles and responsibilities. Taking that multi-year view requires boards to create a structured, ongoing process for succession, instead of an ad hoc approach every time a vacancy looms. The nominating committee is the natural home of the process, but the full board should also take part in regular discussions about the current and developing director pipeline.

Required, not optional

Without a strategic plan for director succession, the board, for lack of better options, may struggle to fill vacancies and ultimately dilute its strength by appointing members who are not strategically well-aligned. Strategic board succession planning dramatically decreases this risk and provides a wealth of benefits:

- The board becomes a pronounced competitive advantage for the company.
- A consciously developed pipeline of potential directors helps ensure that the board will be able to secure the right talent at the right time.
- Long-term planning builds in additional time to thoughtfully identify and cultivate candidates who can bring appropriate differences in perspective, whether it is international experience, experience in an emerging business discipline, gender, race, or the perspective of another culture or industry.
- A carefully constructed rationale for the composition of the board in the context of the long-term future of the company should not only satisfy regulators but signal to proxy advisors and shareholders that the company takes a best practices approach to corporate governance.

Taking a strategic view of board succession planning is becoming a "must have" attribute in a company's corporate governance toolbox. The historical approach of filling seats as they become available must give way to a more deliberate, longer-term perspective on board composition. Understanding this challenge provides boards a starting point into giving the matter the sustained, focused attention that it needs—and to reaping the considerable benefits that come from having the right directors around the boardroom table.

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Egon Zehnder is the world's leading privately owned executive search and talent management consulting firm with over 420 consultants working in 69 offices in 41 countries. The firm specializes in senior level executive search, board consulting and director search, management and team appraisals, and leadership development.

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