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International Corporate Governance Network

ICGN Viewpoint

Ensuring effective board succession planning

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Many best practice companies have crafted sophisticated processes for board succession which helps ensure continuity and sustainability of corporate performance. However, a large number of listed companies are still characterised by a haphazard approach to board succession planning, ranging from a process wholly outsourced to consultants with limited control by the board to an opaque “friends and family” approach where the ultimate decision maker is management or a controlling shareholder.

Boards are responsible for directing the long-term success of companies, and their optimal composition over time is of key importance to investors. Therefore, establishing and maintaining entrepreneurial, independent company boards with the right competences and levels of diversity depends on robust board succession planning. This Viewpoint serves to highlight the principles underlying effective board succession planning as part of the process of good corporate governance to help inform investor and company dialogue on the subject. This includes independence, refreshment, engagement, competence, integrity, transparency and inclusiveness.¹

The process described in this Viewpoint primarily applies to non-executive directors (NEDs) whether they are independent or non-independent. It is important to note that executive succession planning at the level of the C-suite or below is also of great importance, but is outside the focus of this report. However, in the case of executive succession planning, some of the general principles identified in this Viewpoint would also apply.

Composition and independence

Effective board succession planning starts with a clear idea about the optimal board composition: the required knowledge, skills and experience; the percentage of the board that should be composed of independent non-executive directors (INEDS), the level of executive participation and the level of diversity, especially gender diversity. Best practice Codes often contain guidance in these areas. For example, the ICGN Global Governance Principles and the UK Corporate Governance Code both call for a majority of the board to be composed of independent directors while the French AFEP/MEDEF Code requires female board representation of at least 20% in listed companies—supplemented by more stringent legal quotas. Competence and integrity standards are also key in defining the collective profile of the board over time.

It should be noted that in most companies, it is the functional positioning of an executive that will determine if he/she will sit on the board. The individual is selected for the value he/she would bring as an executive rather than as a board member.

Notwithstanding, the nomination committee will always be expected to ensure that the specific individual does have the required experience and judgement to be on the Board, usually by having the final say on the matter.

Board refreshment

Another prerequisite for good board succession planning is a clear idea on board refreshment through the periodic appointment of new members and retirement of incumbent directors. The aim is to appoint directors who provide diverse perspectives, while replacing directors who may no longer have the requisite skills aligned with the company's evolving strategic direction. The effect is to unlock board vacancies and allow for appropriate board diversity to improve board quality. Diverse boards are less prone to 'group think' and more likely to embrace new ways of thinking to meet future company threats and opportunities.

Board service should be contingent on individual director performance and annual re-election premised on satisfactory evaluations of his or her contribution to the board. Refreshment is most often achieved by setting director mandates of an appropriate duration. Most best practice Codes also suggest overall term limits for INEDs, beyond which director re-appointment as an independent director should be exceptional and adequately explained to investors. For example, the UK Corporate Governance Code stipulates that a board should state its reasons if it determines that a director is independent notwithstanding greater than nine years' tenure. But board refreshment should not come at the expense of the board's knowledge and understanding of the company. When not resulting from crisis or change of control, director turnover should be managed so that it preserves an adequate level of institutional memory.

Significant shareholders and engagement

In companies with a significant shareholder of reference - whether an entrepreneur, a family or the government- one or more directors are typically appointed to represent the interests of that shareholder. The presence of these (non-independent) NEDs is not necessarily harmful to the interests of other shareholders, as long as there is a robust system to manage conflicts that might arise from their presence on the board—as well as appropriate transparency on the control of the company by certain shareholders and their representatives on the board.

Best practice companies will make the nomination process inclusive, allowing for various consultations with key shareholders and, often, with other stakeholders (for example, management, banks, employees). Such consultations are even more important for companies with "vocal" shareholders in their registry. Detailed, timely planning and execution of shareholder consultations in this context might avoid the hostility of proxy fights at later stages of the director appointment process --often accompanied by significant waste of funds—at the shareholders' ultimate expense. It is important that all nomination-related discussions with shareholders are conducted in a way that ensures the fairness of all disclosures made in this context.

Board skills and evaluation

The board succession planning process should be described in a clear policy which ensures consistency and rigor in board succession planning. Another key element of the board succession “toolkit” is the board profile “matrix”. This is usually a document in which the skills, competences and diversity needs of the board are mapped against the ones available through the board’s current composition. The matrix helps the board focus its search and write relevant “job descriptions” for the selection of new NEDs in view of upcoming vacancies.

Companies with best practices will perform collective effectiveness reviews of the board as well as individual director performance reviews, often led by the chairman or the senior (or “lead”) independent director when the chairman is an executive. ICGN recommends that a board evaluation is conducted by an external consultant once every three years to help inform candidates of strategic relevance to the company. It is important that the results of these assessments inform the director re-appointment process in the run up to the approval of director elections by shareholders.

After defining their needs and identifying the type of talent they are seeking, many boards will use independent, reputable search consultants to locate potential nominees. While consultants might add value to the process, they should not be in the driving seat. Whether or not search consultants constitute the first layer of “triage” of potential candidates, the board should maintain ownership of the process and ensure a rigorous vetting of the shortlisted candidates through interviews and other means

Nomination / Governance Committee

The criticality of board succession planning requires clear “ownership” by a board committee. Most companies would ask their nomination (or governance) committees to take such ownership. Director nomination is fraught with potential conflict with major shareholders, management or other shareholders, so most corporate governance codes, including ICGN’s Global Governance Principles, call for the committee to include independent directors, at least in its majority. It is also good practice to include the non-executive chair of the board in the composition of the committee, given his/her role in director performance evaluation, and his/her understanding of the board’s needs. The committee would normally run the process from start to finish; it would also select and manage the search consultants, if any. At the end of the process the committee would typically submit its proposals for the approval of the whole board.

Disclosure

If shareholders are to play a positive role in encouraging better board succession planning, they need to be provided with adequate and timely relevant information. While few companies would share publicly their full nomination/succession planning policy and “matrix” due to their sensitivity, some best practice companies provide a good glimpse of how succession is managed in the corporate governance section of

their annual report while others do so in the annual report of the chairman of the board or the nomination committee. In any case, disclosure is about the principles, the policy and the process, not about specific details of individual nominations and appointments. Disclosure of the parameters involved in the above discussions is pertinent, for example, stating that new directors are generally given an expectation that they will serve on the board for an identified period of time or an understanding of what areas the board assessed itself on, including specific objectives, delivering returns or oversight of certain key areas.

Questions for investor and company dialogue

The following questions might guide shareholder enquiries on board succession planning:

- a. Does the company disclose a structured way of identifying its board composition needs?
- b. Is there a board succession planning and nomination policy?
- c. Under this policy, how would the board expect to reach its composition goals?
- d. Does the current board composition meet minimum quality criteria related to competence, integrity, independence and diversity?
- e. Does the company clearly explain its choices about diversity, executive participation and the level of independence?
- f. How does the board identify new competency areas it might require in the next 5 years?
- g. Please describe the parameters used for the board effectiveness evaluation.

About ICGN Viewpoints

This Viewpoint was prepared by ICGN's Board Governance Committee and the text was drafted by committee member Stilpon Nestor. ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate, whilst not necessarily defining a formal ICGN position on the subject. ICGN Viewpoints are produced by our member-led Policy Committees and we encourage dialogue by contacting the ICGN Secretariat as follows:

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