



The Road to Strategic Board Succession

Boards don't always make sufficient time on their meeting agendas to discuss board succession planning. Is their discomfort with the topic getting in the way of doing what's best for the board?

Having the right individuals in the boardroom is critical. Directors need to have the right skills and experience that align with the company's long-term strategy. Diverse and fresh perspectives are also important. So how should boards be thinking strategically about their board succession plan to ensure optimal board composition now and into the future?

Today, boards too often approach succession planning in an episodic manner. It is often addressed only when the board needs to replace a retiring director. This is not overly surprising considering it can be a sensitive topic.

Shareholders and other stakeholders are paying increased attention to board succession planning. Institutional investors are putting pressure on boards to have a more rigorous process around assessing board composition and refreshment. They are asking whether there is enough diversity in the boardroom, if the board has the right skills and how they think about director tenure. Many shareholders also want enhanced disclosure to better understand the board's activities in this area. And, hedge fund activists have also focused on board composition as part of their campaigns.

In our experience, approaches to board succession planning fall along a spectrum. Some boards are highly reactive, and others are strategic — with multiple options in between. Our view is that boards benefit from moving up this continuum toward a more strategic approach.

How can boards be more strategic? They can take the following actions:



Make board succession a priority on the agenda



Take a multi-year view toward departures and upcoming leadership changes



Set directors' expectations around tenure



Assess skills and attributes, and incorporate results from performance assessments



Agree on a plan that prioritizes needs and build a talent pipeline

The board succession planning maturity continuum

Where does your board sit on the curve?

	REACTIVE	PROGRESSING	STRATEGIC
Board leadership and prioritization	Board leadership does not prioritize succession, giving it little focus and having no formal planning process.	Board leadership makes succession a priority for the nominating/governance committee, which leads an annual planning process. There is limited awareness by the full board.	Board leadership makes succession a priority on the board's agenda. The nominating/governance committee leads a regular planning process that is discussed with and agreed upon by the full board.
Time horizon for departures	Succession planning is primarily driven by mandatory retirement age.	Nominating/governance committee takes an annual view of imminent director departures and leadership changes, usually focused on individual board seats.	Nominating/governance committee takes a multi-year view of anticipated director departures and leadership changes, focused on the overall aggregate tenure of the board.
Director tenure expectations	Board does not set expectations for director tenure and related governance policies. Individual director tenure is evaluated on an infrequent or episodic basis.	Board has general conversations about director tenure, particularly as new directors join. The nominating/governance committee periodically considers issues related to individual director tenure.	Board sets clear expectations about director tenure, regularly reviews individual director tenure, and determines the optimal mix of director tenure levels on the board (i.e., new directors, medium-tenure directors and long-tenure directors).
Assessment of director skills	An informal board skills assessment is done to identify skill gaps. Board assessments are viewed as a compliance activity and results are not incorporated into the succession planning process.	A board skills matrix may be used to identify skill gaps, and results from board assessments may be incorporated into the succession planning process.	A board skills matrix is used to identify current and expected skill gaps. Board and director assessments are seen as a continuous improvement exercise and results are incorporated into the succession planning process.
Succession plan and candidate profiles	Nominating/governance committee does not have a formal succession plan. A director candidate profile is usually developed only when a board vacancy is imminent.	There is an annual review of the succession plan and director candidate profiles are maintained. But search efforts are episodic and not linked to the overall succession plan to address prioritized skills and attributes.	Nominating/governance committee maintains a multi-year succession plan and director candidate profiles with a prioritized list of skills and attributes, and a talent pipeline is developed for future needs.

In practice: the board succession planning maturity continuum

Example: John Smith is on the board of ManufactCo. and will reach the board’s mandatory retirement age of 75 in approximately one year. He has a strong traditional manufacturing background and is one of the three audit committee financial experts on the audit committee. Cheryl Jones will reach the mandatory retirement age two years after John. She has deep expertise in financial management and investment banking and is one of the other financial experts on the audit committee.

Reactive

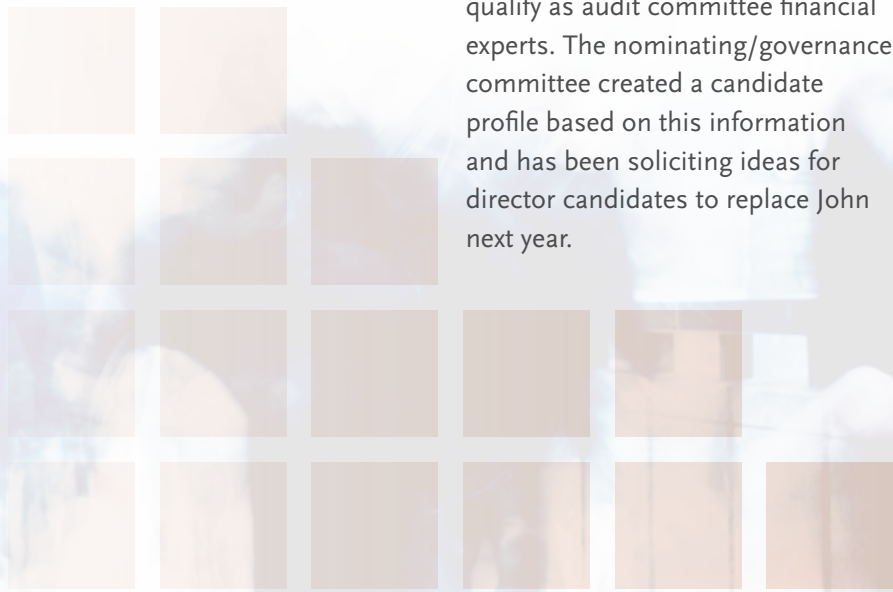
The nominating/governance committee plans to begin searching for a director candidate in the next few months to find a replacement for John. A skills matrix is not used to evaluate broader board needs. The committee will seek a candidate with skills similar to John’s. The annual performance assessment survey did not reveal any substantive changes needed to overall board composition, though several directors suggested skills that may be needed in the future.

Progressing

The nominating/governance committee has been having discussions about John’s departure for over a year because it was identified during annual board succession planning. The committee uses and refreshes the board’s skills matrix each year. It concluded that the company’s digital strategy is becoming increasingly important and a director with digital skills will be critical to board composition. The committee also noted the need for greater gender diversity, and the fact that several other board members qualify as audit committee financial experts. The nominating/governance committee created a candidate profile based on this information and has been soliciting ideas for director candidates to replace John next year.

Strategic

The nominating/governance committee has been preparing for John’s departure for more than a year. It is also planning for the vacancy when Cheryl reaches the mandatory retirement age two years after John. The committee reviewed the results of the board and individual director assessments to consider whether the skill sets of current directors are still relevant. It also regularly updates the board’s skills matrix as part of the succession planning process. This process identified digital skills in the manufacturing industry, gender diversity and operating experience as important to prioritize for overall board composition. The nominating/governance committee created candidate profiles with prioritized skills and attributes for both John’s and Cheryl’s successors. They discussed the succession plan and candidate profiles with the full board. The committee has been actively searching and interviewing director candidates to replace both John and Cheryl. The board’s skills matrix is disclosed in the proxy statement to provide greater transparency to investors.



“A strategic board succession planning process will ensure that the board is positioned to be a strategic asset to the company.”

PAULA LOOP
LEADER, GOVERNANCE INSIGHTS CENTER, PwC



Make board succession a priority on the agenda

Implementing a strategic board succession plan requires effective board and committee leadership. For most boards, the nominating/governance committee oversees the succession planning process. This includes developing and recommending criteria for board composition, addressing board refreshment, creating director candidate profiles and leading the search for new candidates. In addition to the committee, the full board should also understand, review and have input into the plan.

Boards are unlikely to tackle succession planning in a rigorous way unless it is explicitly part of their agenda. So it is critical to regularly carve out time on the nominating/governance committee and board agendas.

Board culture also has a role to play. The culture has to allow for frank and candid dialogue about ongoing board refreshment, director retirements and the need for different director skill sets. These are sensitive, difficult discussions, which make strong board leadership all the more essential.

Shareholders have heightened expectations about understanding the board's succession planning process. They want to understand if a robust plan exists, whether it addresses skills needed in the future and how frequently the topic is discussed, among other items. Some boards are considering whether greater transparency on their approach would be valuable considering shareholders' interest. Today, proxy statement disclosures on board succession planning and practices are fairly limited.



Take a multi-year view toward departures and address upcoming leadership changes

A key part of strategic succession planning is anticipating and proactively addressing planned and unplanned vacancies in the boardroom. Without a plan, the board may feel pressure to waive or change board policies, including mandatory retirement ages, or simply recruit a director with the same profile as the one retiring. This ad hoc approach doesn't allow the board to think more broadly about alternatives that may result in a better fit.

Boards further along the board succession planning maturity continuum take a longer-term view — focusing three to five years out — to effectively address anticipated departures. They create a waterfall chart that identifies all directors, their skill sets and expertise, their board roles (including leadership and committee membership), board tenure, the year they would likely be leaving the board based on expected retirement and other factors. This broader view gives the nominating/governance committee ample time to effectively plan, recruit the right candidate and have a smooth transition.

It is equally important to address the prospect of unexpected turnover, particularly for those directors serving in leadership positions. A plan that considers the potential for such an event to occur positions the board to fill vacancies more quickly.

“The process of identifying potential director candidates, vetting them and reaching out to them to share the board's interest can take many months. Boards that plan well in advance will be in the best position to find the right director candidates that address the board's future needs.”

JULIE HEMBROCK DAUM
LEADER, NORTH AMERICAN BOARD PRACTICE,
SPENCER STUART

Don't be left without an audit committee financial expert

Nominating/governance committees will want to ensure they have properly planned to always have at least one audit committee financial expert (ACFE), as required by SEC rules.¹ Boards left without this critical expertise must note that fact in their disclosures, and explain why.

To avoid being left without an ACFE, many boards have an additional audit committee member who meets the financial expert definition.

For leadership changes due to retirement, committee chair rotation or other reasons, an existing board or committee member is often chosen as successor. This is because the individual already has institutional knowledge of the company, familiarity with the key issues and relationships with the other board or committee members and management. While the successor has this information, leading practice when there is an expected leadership change is for this individual to have a six-month to one-year time period to “shadow” the current leader and obtain deeper insights into the role.

Board leadership roles can't be filled by just anybody on the board. Effective strategic succession planning by the nominating/governance committee should ensure new board leaders have the right skills, time and commitment to perform the role. Board and committee leaders set the tone in the boardroom. They have to be able to promote effective working relationships, handle conflict and be strong facilitators. Specialized knowledge and experience are also critical for audit and compensation committee chairs in order to address the technical issues handled by these committees. Boards also need to take into account regulatory requirements for certain skills — such as financial expertise on audit committees — that will need to be considered when addressing leadership succession.

Top three backgrounds of individuals serving board leadership roles

Lead and presiding director

1. Retired CEO/chair/vice chair/president/COO
2. Investment manager/investors
3. Other corporate executives

Audit committee chair

1. Financial executives/CFO/treasurers
2. Retired CEO/chair/vice chair/president/COO
3. Public accounting executives (retired)

Compensation committee chair

1. Retired CEO/chair/vice chair/president/COO
2. Other corporate executives
3. Investment managers/investors

Nominating/governance committee chair

1. Retired CEO/chair/vice chair/president/COO
2. Investment manager/investors
3. Other corporate executives

Source: Spencer Stuart, 2018 U.S. *Spencer Stuart Board Index*, October 2018.

¹ SEC rules, Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, <https://www.sec.gov/rules/final/33-8177.htm>.

Among S&P 500 companies:

71%
report having a
mandatory retirement
age for directors.

For those boards,
43.5%
set their retirement age at
75 or higher.

Only
5%
set explicit term limits,
with a majority of the
policies set at
15 years
or more.

Source: Spencer Stuart, 2018 U.S. Spencer Stuart Board Index, October 2018.



Set directors' expectations around tenure

Boards further along the succession planning maturity continuum openly discuss and forge agreement on appropriate director turnover and refreshment, and how it will be achieved. Board leadership sets the tone about the length of director service at the outset. They ensure directors understand that re-nominations are not simply assumed — they are based on the evolution of the company and board, and sustained high-performance at the individual director level.

In addition to setting clear expectations around director tenure, boards should periodically assess whether tenure-limiting policies are appropriate. Most boards rely on mandatory retirement policies to promote turnover. In some cases, boards make exceptions to mandatory retirement ages to keep a particular director on the board. This can become problematic as it can set a precedent for all future directors nearing retirement age. Term limits are much less common.

Another area that boards can focus on is the optimal mix of board tenure levels or aggregate board tenure. Some boards seek to balance their composition of new directors, those with medium tenures and those with long tenures.

But boards shouldn't rely solely on tenure-limiting policies to drive turnover. The annual performance assessment can be an effective tool to evaluate board and individual director performance on a regular basis.

Some institutional investors have also been vocal about director tenure. Boards should consider these views as part of their succession planning.



Assess skills and attributes and incorporate results from performance assessments

Nominating/governance committees further along the strategic succession

planning maturity continuum compare the skills and attributes of current directors with those that are critical to the company's long-term strategy to identify and address any gaps. As companies are innovating, implementing new technologies and entering into new markets, their business models may require directors with new or different skill sets. Strategic succession planning should take the company's evolution into account.

The committee should use board composition matrices or a similar tool to help them evaluate their skills and attributes, and include these items as part of their multi-year board succession plan. Boards further along the succession planning maturity continuum share the matrix with their full board for input and agreement. They may even voluntarily disclose these tables, or something similar, in their proxy statements.

Sample board composition matrix

Desired/needed skills, experience, attributes	Director Names								
	A	B	C	D	E	F	G	H	I
International expertise	X								
Technology/digital media expertise				X	X			X	
Risk management expertise			X			X		X	X
Financial expertise		X	X		X				
Marketing expertise									X
Legal expertise		X							
Human resources expertise			X			X			
Operational expertise	X	X	X			X	X		
Industry expertise		X	X		X			X	X
Gender diversity				X			X		
Racial diversity				X					X
Regulatory expertise	X		X			X	X		
Board tenure (years)	15	15	10	8	7	7	4	1	8
Age (years old)	71	74	65	62	60	67	55	47	58

Source: PwC, *Board composition — Key trends and developments*, July 2018.

30% of S&P 500 companies disclose a board skills matrix, or similar type table, in their 2018 proxy statement.²

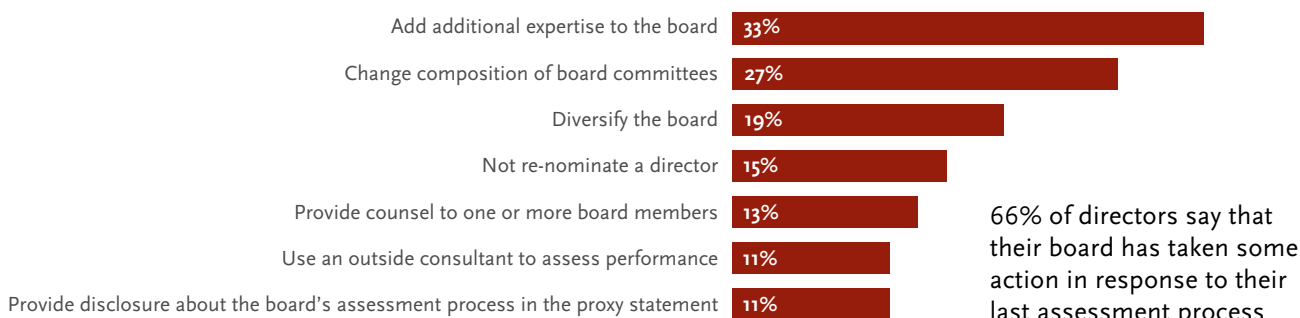
² Spencer Stuart, 2018 *U.S. Spencer Stuart Board Index*, October 2018.

Feedback from the annual board, committee and individual director assessments should also be incorporated into the succession planning process. When assessments are done in a meaningful way, they can help identify whether new or different skills or greater diversity is needed, as well as other changes.

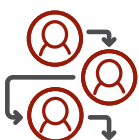
As part of succession planning, boards should understand institutional investors' views about increasing

diversity in the boardroom, with a particular focus on gender diversity. There is a growing recognition that boards with a good mix of age, experience and backgrounds tend to foster better debate and decision making and less groupthink. Many investors view the pace of change as too slow in this area. But boards shouldn't wait for investors to push for increased diversity. Instead, they should ensure that diversity is a board priority.

Board action on assessments



Source: PwC, 2018 Annual Corporate Directors Survey, October 2018.



Agree on a plan that prioritizes needs and build a talent pipeline

Strategic board succession planning processes will bring in discussions around director departures, tenure evaluation, skill set assessment and performance assessment results to agree on a multi-year action plan.

Nominating/governance committees will want to collectively debate, prioritize and settle on the board's future composition needs and a timeline for changes. The key is to be agile and allow the board to make changes as situations or needs arise. For example, some boards have expanded their size to make composition changes faster or to provide an opportunity for a director candidate to shadow another director during a transition period.

Ultimately, the board succession plan and priorities should be reviewed and agreed to by the full board. This action helps the board understand the full complement of directors and how each individual director's skill set

and attributes are relevant to the company. It can help directors understand new skills needed in the boardroom, identify potential future directors, and may be an impetus for further education and skills development for existing directors.

When identifying the board's needs for future director candidates, it is important to be realistic. Boards can fall into the trap of creating a "laundry list" of attributes, desired skill sets and expertise that is unlikely to be filled by one director candidate. Instead, ranking what is most important can make it easier to find appropriate candidates and choose among multiple candidates.

Boards further along the succession planning maturity continuum look not only for a candidate they need now, but also proactively build relationships with potential candidates to develop a talent pipeline. Directors should utilize approaches that look beyond asking other sitting directors for recommendations.

Being realistic: you can't have it all in one candidate

Boards frequently prioritize their need for an active CEO and diverse candidate, but not every board can attract the highly sought-after sitting CEO who is a minority or a woman. The pool of candidates meeting these criteria is small, and many of these individuals

already have board commitments. Only 5.4% of CEOs are female at S&P 500 companies, and only 8% of CEOs are African-American, Hispanic/Latino or Asian at the largest 200 companies.³

³ Spencer Stuart, 2018 *U.S. Spencer Stuart Board Index*, October 2018.

Conclusion

Boards should strive to move up the succession planning maturity continuum toward a strategic approach. A strategic approach delivers benefits to board performance and increases long-term shareholder value. At its best, board succession planning is an iterative process that takes into account the company's evolving business model and the changing governance landscape. This is increasingly important as investors continue to seek greater transparency around the board's activities in this area.

Appendix: What select shareholders say about board succession planning

BlackRock⁴

Responsiveness to shareholders

We expect a board to be engaged and responsive to its shareholders. Where we believe a board has not substantially addressed shareholder concerns, we may vote against the appropriate committees and/or individual directors.

The following illustrates common circumstances:

- The independent chair or lead independent director, members of the nominating/governance committee, and/or the longest tenured director(s), where we observe a lack of board responsiveness to shareholders, evidence of board entrenchment and/or failure to promote adequate **board succession planning**.

State Street Global Advisors (SSGA)⁵

SSGA views board quality as a measure of director independence, **director succession planning**, board diversity, evaluations and refreshment, and company governance practices. SSGA votes for the election/re-election of directors on a case-by-case basis after considering various factors including board quality, general market practice and availability of information on director skills and expertise.

Generally, SSGA will vote against age and term limits unless the company is found to have poor board refreshment and **director succession practices** and has a preponderance of non-executive directors with excessively long tenures serving on the board.

Vanguard⁶

There is a growing role for independent directors in engagement, both on issues over which they hold exclusive purview (such as CEO compensation and **board composition/succession**) and on deepening investors' understanding of the alignment between a company's strategy and governance practices.

CalPERS⁷

Director Succession Plan: The board should proactively lead and be accountable for the development, implementation and continual review of a director succession plan. Board members should be required to have a thorough understanding of the characteristics necessary to effectively oversee management's execution of a long-term strategy that optimizes operating performance, profitability and shareowner value creation.

At a minimum, the **director succession planning** process should:

- Become a routine topic of discussion by the board.
- Encompass how expected future board retirements or the occurrence of unexpected director turnover as a result of death, disability or untimely departure is addressed in a timely manner.
- Encompass how director turnover either through transitioning off the board or as a result of rotating committee assignments and leadership is addressed in a timely manner.
- Provide for a mechanism to solicit shareowner input.
- Be disclosed to shareowners on an annual basis and in a manner that would not jeopardize the implementation of an effective and timely director succession plan.

⁴ BlackRock, *Proxy voting guidelines for U.S. securities*, February 2018.

⁵ State Street Global Advisors, *Proxy Voting and Engagement Guidelines*, March 2018.

⁶ F. William McNabb III, Chairman and CEO, The Vanguard Group, *An open letter to directors of public companies worldwide*, August 31, 2017. <https://about.vanguard.com/investment-stewardship/governance-letter-to-companies.pdf>.

⁷ California Public Employees' Retirement System, *Total Fund Investment Policy*, November 2017.

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