Succession planning and the nomination committee

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KPMG Board Leadership Centre

FTSE350 breakfast with Kit Bingham and Mark Freebairn

Kit Bingham (Partner and Head of the Chair and Non-Executive Director Practice) and Mark Freebairn (Partner and Head of the Financial Management Practice) from Odgers Berndtson joined our FTSE350 breakfast to lead a discussion about succession planning and other issues high on the nomination committee agenda. We highlight ten key areas emerging from the discussion.

1 Reform – friend or foe?

The proposed changes to the UK Corporate Governance Code will impact board composition and consequently the role of the nomination committee. To what extent divides opinion. Whilst not entirely revolutionary, the proposals around chair independence and board tenure being capped at nine years have potentially wide-reaching implications for many companies.

The implication of the proposals is that in order to comply, chairs would need to stand down after nine years. In practical terms, if companies were to comply (rather than explain) we understand that around 20% of FTSE350 chairs would fall foul of this new test, and while we accept that the comply or explain regime could be used to rationalise non-compliance with the Code, the reality is that this change will drive board leadership churn at unprecedented levels.

A number of attendees also challenged the Financial Reporting Council's assertion that board chairs should be independent throughout their tenure as the necessary relationship between the chair and CEO creates relationships and circumstances which could appear to affect the chair's judgement.

2 Within the board's control

Boards have an opportunity to enhance both the nomination committee's profile and an understanding of its role in supporting strategic development and operational excellence.

Investors are increasingly interested in succession planning arrangements and how boards assess both director and management performance, yet it can be argued that many nomination committee reports lack the rigour and attention to detail associated with both audit committee and remuneration committee reports.

Notwithstanding the potential commercial and personal sensitivity when reporting on succession plans, the quality of reporting could be greatly improved. Annual reporting can explain clearly the overarching succession planning process including how far ahead they look, how they search, select and appoint new candidates, and what sort of skills, experience and expertise are needed.

3 Having a plan

Succession planning could be more proactive, with a greater degree of discipline, structure and reporting – whilst appreciating that without a leaving date, succession planning is just contingency planning. "Everyone has a plan until they get punched in the mouth." (Mike Tyson)

Having an individual (e.g., the chair) drive a proactive plan well ahead of time, can be an effective way of targeting and securing the best pool of candidates, and ultimately the best hire.

Innovative ways of progressing board succession – particularly with respect to CEO and CFO succession include:

- developing strong mentoring programmes for internal talent, ideally giving cross-functional perspectives on development and progression;
- creating shadow boards - perhaps supervised by the Senior Independent Director (SID) – to discuss, debate and comment on the same issues as the main board. (This might also help develop the SID into a prospective board chair);
- an open and honest process agreed with the incumbent CEO early within their tenure to appoint a recruitment firm to deploy a discreet talent mapping and shortlisting exercise for their succession; and
- a "try before you buy" approach, with internal candidates instructed by the board to run a series of CEO-level projects.

4 The rise of the CFO

We are seeing more finance directors emerging as CEO successors, indicative of the influence and breadth that the finance role now requires. This is driving a broader and more senior role for the finance director's deputy/financial controller – and a further opportunity for the development of internal talent.

5 A diverse board is a better board

Does the board have the right combination of skills, backgrounds, experiences, and perspectives to probe management's strategic assumptions and help the company navigate an increasingly volatile and fast-paced global environment?

Consider the richness of the board as a whole. Does it include people with different skills, qualities, experiences, backgrounds and perspectives who together are more able to consider issues in a rounded, holistic way and offer an attention to detail that might not be present on less diverse boards. Geographical or international diversity is also important for businesses operating across many different markets.

6 Look forwards, not backwards

Succession planning provides a fresh opportunity to ensure that the CEO is not just "recruiting in their own image". Their characteristics should have been fitting at the time of their appointment but may no longer be appropriate when the successor is due to take over. A proactive nomination committee can also better manage and be prepared for the risks associated with internal candidates not progressing in a recruitment process.

Being clear about overall objectives in succession planning is key. For example, the business may be looking for dramatic transformation which may see external candidates better placed to lead the organisation going forward.

7 The board as a catalyst for culture

When considering the composition of the board (and senior management team), nomination committees need to be cognizant of the key role played by such individuals in both determining and sustaining the desired corporate culture. Cultural change may be expedited by the appointment of a CEO from outside the organisation – someone who isn't part of the fabric of the existing culture.

8 Committee composition

Whilst the composition of the nomination committee will very much depend on the organisational structure and the number of board members, usually, in smaller companies, the committee is comprised of all of the non-executive directors. For larger boards this is less realistic and makes the inter-committee communication even more critical – particularly between the nomination committee and remuneration committee.

9 Workers on boards?

The proposed revisions to the UK Corporate Governance Code suggest that boards should normally employ either a workforce director, a formal workforce advisory panel or a designated non-executive director to gather the views of the workforce.

Attendees anticipated that few companies would opt for a workforce director or a designated non-executive. The preferred choice of most would be a formal workforce advisory panel or some other mechanism to gather the views of employees – whether that be workforce annual general meetings, the creation of junior boards, informal work councils or board-led town hall meetings and cascades. Feedback mechanisms also require some thought.

10 The influence of the regulator

Financial services regulators have shown an increased interest in both board composition and how boards discharge their duties. This includes regulators attending board meetings and requesting copies of board effectiveness reviews. Some attendees thought that the intensity of this approach had eased up a little of late, but that nevertheless it can be argued that regulators are "doing the shareholder's job". Some felt that intense regulatory involvement can heavily influence the culture of the board and if left unchecked can drive both narrow thinking and adversarial behaviour in the boardroom.

New regulation such as the Single Supervisory Mechanism (SSM) in banking may also provide an impetus towards board recruitment focussed on technical knowledge causing a further shift towards a compliance mind-set rather than strategic thinking.

Please also read our papers:

On the 2018 Nomination Committee Agenda

Board composition: Ten questions for non-executive directors

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