

Lead Director Network ViewPoints

Issue 7 March 29, 2010



The lead director's role in board succession planning

Introduction

The sixth meeting of the Lead Director Network (LDN)¹ was held in New York City on March 2, 2010. Members discussed two topics: the lead director's role in major transactions² and the lead director's role in board succession planning. The lead directors who participated in the March 2, 2010 meeting included:

- Frank Blount – Presiding Director, Caterpillar; Lead Director, KBR
- Roy Bostock – Non-executive Chairman, Yahoo!
- Peter Browning – Lead Director, Nucor
- Dan Carp – Non-executive Chairman, Delta Air Lines
- Ray Gilmartin – Lead Director, Microsoft; Presiding Director, General Mills
- Dick Goldstein – Presiding Director, Interpublic Group
- Bonnie Hill – Lead Director, Home Depot
- Karen Horn – Presiding Director, Eli Lilly
- Phil Humann – Presiding Director, Coca-Cola Enterprises and Equifax
- Ed Kangas – Non-executive Chairman, Tenet Healthcare
- Linda Fayne Levinson – Lead Director, NCR
- Jack O'Brien – Lead Director, TJX; Non-executive chairman, Cabot
- Ken Powell – Lead Director, Medtronic
- Jim Robinson – Presiding Director, The Coca-Cola Company
- Wes von Schack – Lead Director, Bank of New York Mellon

King & Spalding partners participating in the meeting were:

- J. Kelley, Partner, Corporate Practice Group
- Chris Wray, Partner, Chair Special Matters and Government Investigations Group

ViewPoints reflects the network's use of a modified version of the Chatham House Rule, whereby names of members and their company affiliations are a matter of public record, but comments made before, during, and after meetings are not attributed to individuals or their companies. Members' comments at the meeting are shown in italics. For further information about *ViewPoints*, see "About this document," on page 6.

¹ The LDN brings together a select group of lead directors, presiding directors, and non-executive chairs from Fortune 500 companies for private, candid discussions about ways to improve board governance. For the purposes of this network, the term *lead director* is used to refer to all three titles – lead director, presiding director, and non-executive chairman – except where otherwise stated.

² See Lead Director Network, "[The lead director's role in major transactions](#)," *ViewPoints*, March 29, 2010.

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Executive summary

In a previous meeting of the LDN, members discussed the lead director's role in CEO and management succession planning. The March meeting followed up on that discussion, with a consideration of board succession planning.³

At most companies, the nominating and governance committee is responsible for overseeing director succession planning. In many cases, the lead director is the chair of that committee⁴ and therefore is responsible for guiding board succession planning. Yet members emphasized that even when the lead director does not chair the nominating and governance committee, he or she assumes a critical role in the board succession process. One member said, *"I lead the discussion around board turnover and board succession."* During the March meeting, LDN members focused on the following areas which are discussed in more detail on the following pages:

- **Board succession** (*Page 2*)

Lead directors and boards must answer a variety of important questions when they undertake board succession planning. These include whether boards should recruit beyond the typical skills matrix for new candidates, whether and to what extent diversity should be considered in candidate searches, and who to turn to for help in identifying viable candidates.

- **Lead director succession** (*Page 5*)

Although lead director succession planning is not necessarily top-of-mind for boards, it is a critical component of board succession. Members advised boards to begin preparing for the lead director transition, to consider what an appropriate length of service is for the lead director, and to determine how involved the CEO should be in the transition process.

Board succession

Members discussed three areas within board succession: recruiting beyond the skills matrix, considerations of diversity, and methods for identifying board candidates.

Recruiting beyond the skills matrix

It is common practice for the governance committee to maintain a matrix describing the skills, age, length of service, and background of each current board director. This matrix informs the board's decisions regarding recruitment of new board members. During the LDN meeting, members debated the merits of recruiting people specifically to fill gaps identified in the skills matrix (such as industry knowledge or experience working in a particular market) as opposed to recruiting talented generalists with a broad business background.

Members said the skills matrix is helpful in certain instances: *"[It] does help when you're trying to account for the directors' retirements or for evaluating the board's current skill set."* However, most members

³ See Lead Director Network, "[The lead director's role in succession planning](#)," *ViewPoints*, December 11, 2009.

⁴ Of the 15 members who attended the sixth LDN meeting, 11 are also chairmen of their companies' nominating and governance committees.

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agreed that lead directors should encourage their boards to go beyond these matrices. One member said, “[Board succession] is an integrated thinking and judgment exercise ... I think the skills matrix is interesting, but ... I’ve been on boards that were formed using only a skills matrix, and it took many years to form an effective board.” Another member agreed: “You have to look for the broader categories. One of my boards looks for smart people and is less concerned with checking any boxes.”

Members also said that boards need to consider overall composition: “It is our collective responsibility [the board’s and the lead director’s] to prevent the board from becoming compartmentalized with too many specialists who have one type of expertise.”

Consideration of diversity

Effective at the end of February 2010, the Securities and Exchange Commission (SEC) amended its rules on what information companies make available to shareholders regarding the role that diversity plays in the nomination of candidates for board positions. The SEC’s *Proxy Disclosure Enhancements Release* states,

It is useful for investors to understand how the board considers and addresses diversity, as well as the board’s assessment of the implementation of its diversity policy ... We are adopting amendments ... to require disclosure of whether, and if so how, a nominating committee considers diversity in identifying nominees for director.⁵

Board diversity is an important issue for boards and their lead directors. Most members report that their companies already consider diversity for the board: “We’re not changing our approach to diversity [because of the SEC’s rules]; this is something we’re already aware of and working on.” Members said their boards and nominating committees consider different aspects of diversity and link diversity goals to the company’s overall strategic plan: “We tie everything into our long-term strategic plan and trying to determine the qualifications and criteria for the best board.”

The two aspects of diversity most commonly mentioned in the meeting were age and degree of international experience:

- **Retirement age and activity levels.** One member said, “Age is a component of our diversity plan. We implemented a retirement age ... [because] we knew we needed to continue adding new directors.” A member described one board having an “activity clause” for the directors to prevent inactive directors from remaining on the board: “Board members need to remain actively engaged in business activities and education. When people retire from a senior executive job, such as a CEO position, they need to stay actively engaged in business [activities] ... So we’ve put a clause in our [corporate governance guidelines] that our directors must spend a majority of their time actively engaged, and if the board members want to retire [from business activity], it’s time for them to leave the board.”
- **International experience.** Another member noted, “Most of our revenues are from outside the US, so we want to consider including board members who can represent that [non-US] perspective.”

⁵ Securities and Exchange Commission, Release No. 33-9089, *Proxy Disclosure Enhancements* (Washington, DC: US Securities and Exchange Commission, 2009), 38.

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Methods for identifying board candidates

Members identified three potential avenues to explore when initiating the board succession planning process: search firms, the board's personal network, and external constituencies.

Search firms

Most LDN members have engaged search firms to support the board succession process. However, members' opinions diverged regarding the value of these firms. One member said, *"We don't have a high success rate with search firms. They keep sending us the same names of board candidates again and again."* Another member said, *"I have had good luck with our company's search firm, but I understand that it depends on the circumstances."*

LDN members suggested two specific actions boards can take to make search firms a more effective tool:

- **Build a long-term relationship with a single search firm or consultant.** *"We have used the same consultant for all the years that I've been on the board, and he is terrific. He helped me build the board from scratch ... I've called him periodically through the years and he's always been able to help."*
- **Ensure the search firm develops knowledge of the company.** *"We used a consultant who is very good, and the board was surprised at how productive the relationship has been. This consultant understands the needs of the board and the importance of chemistry. He understands that it's more than just having [candidates] with good business experience."*

The board's personal network

One member said, *"We've tried hiring outside search firms, but have had limited success. We use our own contacts to get additional directors. We have better luck with our own networks than with search firms."* Another member echoed this observation: *"Some of the best candidates we've had have come from [suggestions by] other board members."*

External constituencies

Some members have turned to outside constituencies in an effort to build a more comprehensive list of potential board candidates: *"We asked our long-term shareholders for suggestions on our next board member. Mostly what they said was that they really appreciated the opportunity to get involved. Now we're in the process of going back and letting them know the status of their particular candidates."*

Another member accepts informal suggestions for board candidates: *"I talk to a number of outside constituencies. I don't ask for recommendations, but suggestions and input on key people ... We might add some of them to the pot of candidates ... One of our directors came from that process."*

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Lead director succession

Eight of the 15 members who participated in the LDN meeting are their company's first lead director,⁶ suggesting that a period of lead director transition may be looming for many leading US companies. Members discussed how to prepare for the transition, how long the lead director should serve, and how involved the CEO should be in the transition process.

Preparing for lead director succession

Members noted that it can be hard to begin planning for a change in the lead director. One member stated, *"I have encouraged [the board] to start looking for another lead director, but ... it's been difficult to have the conversation with the board because they're satisfied with how I'm doing."* Another member concurred: *"I have [several] more years on the board. At the same time, I'd like to see someone else be lead director, but there's reluctance because I have relationships with some of our shareholders, and there's a tendency for the board to get to a comfort level with the current lead director."*

One member addressed this difficulty by making lead director succession something that is discussed with committee chair rotation: *"We are transitioning [our lead director] over the next year or so. It's part of the committee rotation process because the lead director is the chair of the nominating committee, so as you start planning for committee rotation, you factor in the next lead director. We have identified that person, who is already serving on my committee, so when I transition, it will be smooth. There is a shadowing process that goes on."*

Term length

Members had differing opinions on the optimal term for the lead director. One member said, *"We transition every three to five years."* Another member countered, *"Three to five years is too short. It takes time for a director to achieve his greatest effectiveness. My attitude is, let [the lead director] work."*

One member pointed out a problem that can arise if the same lead director is in place for a long period of time: *"The tendency of the board is to defer to the lead director, and I'm struggling with that, and it's making me think it's time for a transition [in the role] ... [The board] shouldn't become so comfortable with me that they leave all the [board leadership] up to me."*

CEO input on lead director succession

LDN members seek input from the full board and the CEO regarding possible lead director candidates, but members cautioned that boards should not rely too heavily on the CEO's suggestions. One member said, *"I talked to the full board and got the CEO's input on the next [lead director]."* Another member said, *"[The CEO] has veto power, but not the right to pick the next lead director."* A third member elaborated: *"You don't want the CEO picking the next lead director, but you have to be aware that the CEO and lead director will need to work together."*

⁶ If a member was a lead director at two companies, and was the first lead director at either or both companies, he or she was counted only once.

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Conclusion

Members agreed that a robust board succession planning process is critical: “[Lead director rotation] can sometimes sneak up on the board ... It’s best to begin to choose a successor and start preparing them for the job.” But members stressed that there is no single best approach to director succession: “There’s no one size fits all. We all approach this very differently.” Members encouraged lead directors to consider the broader implications of the board’s decisions surrounding board succession: lead directors must consider the issue not only in terms of who is best to fill a single board position, but also within the broader context of building the best board for the long term: “It’s our responsibility to look at the board and say, ‘how good is this board for this company?’”

About this document

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the issues confronting lead directors. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *ViewPoints* is encouraged to share it with those in their own companies and with their colleagues at other companies. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

The Lead Director Network (“LDN”) is sponsored by King & Spalding and convened by Tapestry Networks. The LDN is a group of lead independent directors, presiding directors, and non-executive chairmen drawn from America’s leading corporations who are committed to improving the performance of their companies and to earning the trust of their shareholders through more effective board leadership. The views expressed in this document do not constitute the advice of network members, their companies, King & Spalding, or Tapestry Networks.

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