INSTITUTE OF DIRECTORS
SOUTHERN AFRICA

Succession Planning for the Governing Body

Corporate Governance Network

August 2017

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Introduction

Today's business environment is marked by a state of constant change. Just about every business is impacted by some form of transformation, whether it be regulation, market disruption, innovative technologies, new business models or other forms of competitive pressure. One of the keys to a successful business is its ability to assemble the right individuals capable of strategically steering the business through these changing conditions. In the wake of these changes, governing bodies should be prepared to evolve in a similar way in order to remain relevant and provide effective guidance to and oversight over management.

Governing bodies may also find themselves in a situation where their members are retiring as part of a pre-planned orderly process or in an unexpected manner. Without appropriate planning, these situations have the potential to create uncertainty, instability and a potential risk to the organisation.

King IV™[1] highlights the importance of a succession plan for both executive and non-executive governing body members as critical to the effectiveness of the governing body. Practice 13 of Principle 7 states "*the governing body should establish a succession plan for its membership which should include the identification, mentorship and development of future candidates*." Without appropriate succession planning, the consequences may well be instability and risks to the organisation. The paper focuses primarily on succession planning for non-executive directors.

There is an integral link between succession planning and the composition of the governing body. This paper should therefore be read in conjunction with the CGN Paper on Governing Body Composition[2].

Purpose of this paper

This paper addresses how the governing body, or, if one exists, the committee responsible for nominations, can take a more proactive approach to planning for succession, both when a change is expected, as well as unexpected.

Responsibility for succession planning

The governing body bears ultimate responsibility for the succession plan. In line with King IV, Principle 8, Practice 60, many organisations allocate the oversight of the governing body succession plan to a committee responsible for nominations, or another governing body committee. This committee would then report to the governing body as regularly as is required. If, as is the case for some smaller organisations, a committee is not established, the governing body should ensure that it fulfils this responsibility. The nomination, selection and appointment process, for prospective governing governing body members is further discussed in the publication on governing body composition.

Value of a staggered succession plan

Most organisations adopt a process of staggered rotation to ensure a continuity of experience and knowledge and to introduce people with new ideas and expertise (if not already regulated by the organisation's internal policies or relevant regulation).

1 The King IV Report on Corporate Governance for South Africa 2016, Institute of Directors in Southern Africa NPC (IoDSA), *http://www.iodsa.co.za/page/KingIVReport*, Trade marks and copyright owned by the IoDSA
2 *http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/05E93ACB-10BE-4507-9601-307A66F34BD8/Corporate_Governance_Network__Governing_Body_ Composition.pdf*

The role of the shareholder

Shareholders ultimately appoint the members onto a governing body. However, the committee responsible for nominations (and/or governing body) plays a critical role by short-listing viable candidates for nomination. In the absence of a strong process from the nominations committee, shareholders may be left in the unenviable position of electing governing body members without necessarily having a complete insight into the needs of the governing body or governing body members who do not possess the appropriate level of insight, knowledge and experience.

Shareholders should be actively engaged and involved in the matters that require their attention and on which they are required to vote. This discussion will be enhanced by a positive approach by both parties, that is, by the shareholders discussing nominations with the governing body in an open and frank forum and the governing body actively taking the discussion to the shareholders on what the needs of the governing body are. In an era of proactive stakeholder engagement, the appointment of governing body members should not result in surprises if there has been open communication throughout the process.

Good practice is that shareholders should consult with the governing body before appointing governing body members. However where shareholders appoint members directly without consultation with the governing body, the governing body and shareholders should develop a process for ensuring appropriate and timely dialogue between the parties. Governing body members appointed directly by shareholders should be subjected to the same level of scrutiny and process as other members elected to the governing body. The governing body continues to have a responsibility to perform due diligence on the appointed members. Refer to the CGN Paper on Director due diligence [3].

The role of the governing body or committee responsible for nominations

The committee responsible for nominations plays a key role in devising criteria for governing body membership and governing body positions and possibly, with the assistance of external advisors, to identify specific individuals for nomination. To be effective and impartial in its activities, the committee should mainly consist of independent non-executive directors. It is important that the nomination committee consults regularly with a sufficient number of shareholders during the nomination process and seek their approval of the proposed changes to the governing body. Without such engagement, these proposed changes to the governing body run the risk of not matching the expectations of the key stakeholders and not being supported, rendering them ineffective.

A skills matrix should be developed that displays the governing body's desired competencies, current members who fill each competency, and skills gaps that need to be filled by potential candidates. Once the skills matrix has been developed, the nomination committee can then determine where gaps lie in governing body diversity, skills and abilities. A profile of skills, qualities and demographics can then be developed for use in the succession planning and recruiting of new governing body members.

The succession discussion needs to feature on the nomination committee agenda as often as is required for the nomination committee to fulfil its duties. This allows the succession plan to take account of the changing dynamics of the business, and makes the organisation more agile and enhances its ability to satisfactorily react to any sudden changes that may occur.

3. *http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/05E93ACB-10BE-4507-9601-307A66F34BD8/IoD_Due_Diligence_Brochure.pdf*

Governing body considerations

The governance structure and culture of a governing body impacts on succession planning, governing body size, committee make-up, director compensation and the relationship between the governing body and its stakeholders. In planning for succession, governing bodies should consider the following:

- Is there a formal succession plan in place for governing body members (executive and non executive), the chair of the governing body, and other key role players, in place?
- Is the succession plan regularly evaluated in line with changing circumstances of the organisation?
- Is the succession discussion a regular feature on the governing body or nomination committee agenda?
- Are there ready candidates to consider to replace the CEO if an unforeseen event occurs (i.e. interim vs long term plan), and have we engaged closely with the incumbent in order to facilitate the smooth transition?
- What is the strategic direction of the organisation and what are the key skills required of governing body members to effectively implement the strategy?
- Have the profiles, selection criteria (including skills and experience) of the candidates been defined?
- What processes are in place to identify governing body members? Example, do we use head-hunters or external consultant?
- Is there a balanced composition of people appointed to the governing body, and is this in line with the relevant legislation, standards and best practices e.g. King IV?
- Is there a communication plan (including consideration of regulatory requirements like the listings requirements where relevant) to deal with any changes in governing body membership?
- Does the governing body evaluation process include an evaluation of issues of succession planning?

Identifying candidates and their appointment

It may be helpful to consult external resources to identify appropriate individuals to fill vacant positions. This may involve engaging with search consultants and industry experts. Search consultants often have the ability to discreetly test potential members' interest in a new governing body role and their future availability, and also to look globally at new candidate pools such as individuals with digital experience.

The committee responsible for nomination or, in absence of this committee, the chair of the governing body should consult with other governing body members concerning the recommendation for appointment of new non-executive governing body members. The formal recommendation of any new member should be by the full governing body, assisted by the nominations committee, to be ratified at the Annual General Meeting.

Once a suitable candidate is appointed, a thorough transition plan should be developed. He/she should meet regularly with the chair, lead independent director and other stakeholders to have an in depth discussion regarding the operating styles, histories and expectations of the governing body and the senior management as well as other stakeholders' constituencies including investors, customers, regulators and creditors.

Term of office in relation to succession planning

The governing body should consider whether it will impose reasonable term or age limits, such as a maximum of three or four consecutive three-year terms or a specified age limit, to encourage the governing body to keep its pipeline fuelled with prospective new members and key role players. Although these limits have the disadvantage of forcing retirement of some highly competent members, they have the potential to encourage a continuing flow of fresh thinking, objectivity, and diversity of thought into the work of the governing body. The governing body should be cautious of the use of the arbitrary limits. If used, the limits should be considered together with other criteria for assessing the effectiveness of the governing body.

The succession plan must include an emergency plan in addition to the long term plan so that in the event of an unplanned vacancy, the governing body can either quickly decide on a successor or, if there is no obvious choice, designate an interim governing body member and, if necessary, a temporary reassignment of duties amongst the governing body members.

Like all governing body duties, the succession planning process should be evaluated as part of ongoing assessment. The nomination committee should update its list of desired competencies on a regular basis to ensure that it is current.

The paper has not dealt with retirement of executive directors by rotation. The retirement by rotation of executive directors is generally not encouraged. This is further discussed in the King III practice note relating to this matter [4].

Conclusion

The need for careful planning of governing body succession is greater today in light of the inherently dynamic business environment, regulators and the demand for diversity and a broader set of skills to support changes in company strategies. All governing bodies, from major corporations to non-profit organizations, need to demonstrate their willingness to evolve if they are to remain relevant. Governing bodies should develop an effective and transparent governing body succession plan.

4. http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/24CB4885-33FA-4D34-BB84-E559E336FF4E/king_III_Retirement_by_rotation_of_executive_directors_.pdf

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