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Catherine Woods
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Dear Ms Woods,

Discussion Paper: UK Board Succession Planning

Chartered Accountants Ireland welcomes the opportunity to comment on the discussion paper on UK Board Succession Planning as part of the Financial Reporting Council's consultation on this issue.

Our response is aimed at promoting succession planning practices that develop value-add boards and support long-term organisational success. We provide broad comments on the topic and address some of the specific questions and issues highlighted in the discussion paper.

We would be delighted to discuss our comments with you, and to participate in any further consultations on this issue.

Sincerely,

MHalton

Dr Mary Halton
Chartered Accountants Ireland

BACKGROUND AND CONTEXT

The UK Corporate Governance Code applies to a number of companies listed in Ireland and has been voluntarily adopted by others. In preparing our response, we have sought input from interested stakeholders, including our members, the Ethics and Governance Committee of the Institute and members of the boards and nomination committees of companies listed on the Irish Stock Exchange. Comments draw on recent board research and also reflect outputs from a roundtable discussion among business leaders from a range of sectors, chaired by the President of the Institute, and convened specifically to address key aspects of the FRC discussion paper.

In response to questions and issues posed by the discussion paper, an executive summary outlines a number of points we believe warrant further consideration. Comments supporting each of these suggestions are then provided in four main sections: the nominations committee; board evaluation; pipeline; and diversity. Brief conclusions are then set out.

EXECUTIVE SUMMARY

The board has overarching responsibility for setting the strategic aims of the company and overseeing their implementation. It also has a fundamental role to play in shaping and embedding the culture that informs organisational behaviour and guides day-to-day operations. Success in these areas is inextricably linked to having the right people in the right places at the right time. It follows therefore that succession planning should be actively managed and closely aligned to both the agreed business strategy and the desired culture. In achieving this, and in response to issues raised in the discussion paper, a number of points that warrant consideration are identified:

- A common and consistent understanding is needed around how best to structure and compose the nominations committee in order to support effective delivery of its role. Thought-leadership and more practical guidance on the growing role of the committee would be helpful.

- Measures to increase diversity in positions of power, including on the nominations committee, will encourage variety in perspectives that will feed through to the development and operation of the board.

- Initiatives to shift mind-sets and increasingly link active board refreshment to strategic priorities rather than a minimum expected tenure may be helpful. Similarly, a continued focus on the business case for diversity will help to crystallise further benefits.

- Board evaluation that moves past a tick-box exercise to objectively assess the quality of the board dynamic and the behaviours around the table would usefully inform succession planning, the nominations process and ongoing board development. Initiatives to increase understanding of board dynamics, and the extent to which they can influence board effectiveness, may encourage boards to move more quickly in this direction.

- In assessing and shaping deeper layers of the talent pool, a number of initiatives might be considered by the board, as outlined in the supporting comments below. However, more clarity is needed about the role of the board vis-vis that of management. Expectations of the non-executive role have increased significantly in recent years, and care is needed in setting out the role of the board in this area.

- The executive director role has not experienced the same development in recent years as that of the non-executive. While the roles differ, directors nonetheless share legal responsibility for the organisation. Stepping up to the board as an executive director requires a significant shift in thinking, and appropriate training and guidance are essential to ensure that internal candidates are board-ready and successfully make the transition.

- Diversity is needed on a number of fronts, including gender. Many directors are unconvinced by commonly cited arguments suggesting a shortage of able female candidates. A further review of the process for identifying potential candidates would be helpful. In particular, continued emphasis on broadening the criteria applied may encourage companies to re-assess how different directors may add value. In addition, increased investment in onboarding directors, including directors that do not have prior relevant experience, may help to overcome concerns.

- An increased focus on ensuring that more women progress up through the executive ranks and into the top positions is needed. Voluntary targets and quotas for women on boards have proven effective and are worth further consideration in this regard.

- As with any change programme, a critical element is communication. Continued focus on linking strategic priorities to active board refreshment and diversity would be helpful in maintaining the momentum of change.

SUPPORTING COMMENTS

Section 1: The Nominations Committee

The nominations committee has come under increased scrutiny as companies continue to develop the board evaluation process, actively address succession planning and look to identify and appoint a diverse cohort of directors. In assessing the committee's effectiveness and how its standing might be improved, a number of considerations emerge.

Role

Experiences indicate that the role of the nominations committee in many organisations is currently under development. Companies are at different stages in cultivating the role, and some committees play an influential part in discharging board responsibilities. In others, the committee acts largely as an implementer of decisions, as the comments of these directors illustrate:

> 'The nomination committee is reactive. The need for a different talent or diversity or whatever has come from the main board and then the nominations committee has tended to be the processor of the search or interviewer of the candidates'.
>
> 'It tends to be other people do the work in terms of finding the candidates. The nominations committee do the rubber-stamping in terms of the last bit, but in terms of the work, it tends to be done by other people, either executives in the business, or other directors who don't happen to be on the nominations committee. So, it's interesting, the success of the committee is dependent on having the right people on it in the first place'.

It follows that the role and purpose of the committee requires further consideration and increased common understanding across businesses. The Code currently provides valuable direction in this regard. However, there is significantly less guidance and lived experience available to the nominations committee than is available to other committees such as audit, for example. The comments of this director illustrate:

> ‘Compared to audit committee and remuneration committee, there’s maybe less out there in terms of guidance around it. Other committees have evolved over quite a long period of time and there’s a lot of learning and development in framing them…... The nominations committee is just coming into that space. In terms of its scope and role, we are probably learning as much as anything’.

This suggests that nominations committees would benefit from access to more practical guidance on their role as well as opportunities to learn from the experiences of other organisations. Thought-leadership in this area would be helpful, as would practical tools and opportunities for knowledge–sharing.

Composition

The composition of the committee is fundamental to its success. Small committees are common and having people with the right skills and experience to handle sensitive issues is important. There are variations however in the make-up of committees, with some companies opting for non-executive members only, while others include the CEO and perhaps other executives. The different approaches across companies suggest a need for increased understanding of how best to construct the committee, and to understand more fully the influence of various players in ultimately shaping the composition of the board.

A further point in this regard relates to the issue of diversity. Nominations committees commonly include or are chaired by the board chair, yet research indicates that globally, only 4% of board chairs are women[1]. The recent five year summary of the Davies Review of Women on Boards indicates that only three of the UK FTSE 100 companies have female chairs[2], and in Ireland, no company listed on the ISE Main Securities Market currently has a female chair. Women are also commonly under-represented at CEO level. Finding ways to increase diversity in positions of power, including on the nominations committee, will encourage variety in perspectives that can feed through to the development and operation of the board. Quotas or targets may be helpful in this regard, discussed further in Section 4 below.

Succession planning matrices

Succession planning matrices are commonly used and often developed in-house. Director tenure is a cornerstone in the process, and the Code guidelines on this help in forecasting skills gaps. There is scope for further development of matrices, including by strengthening links with diversity targets, addressed below, and with the strategic plan. However, ensuring that board refreshment actively reflects the strategic needs of the organisation is not always a straightforward task. Issues include, for example, the traditional expectation that directors will serve their full term. Comments of this director illustrate:

> ‘Something that’s a challenge for companies is where you have a particular board and the strategic plan of the business changes, it’s hard to ask board members to leave if they are not finished their term. People have a natural tendency I think to let them finish their term and then replace them, where companies need to get faster at changing it around. I think a change in the board does help the company outperform because you get the right people in’.

Reluctance to leave early may be partly because such a move attracts questions, often unwarranted, about abilities and fit. Initiatives to shift this mind-set and increasingly link active board refreshment to strategic priorities rather than a minimum expected tenure would be helpful.

Nominations process

The nominations process for non-executive directors has changed considerably in many organisations, though it still differs to the approach taken when appointing senior executives. Sensitivities often remain about losing face if the appointment does not progress, for example, and while interviews are common, other assessments used in executive recruitment are not considered appropriate. As noted in the discussion paper, and supported by wider research, the nomination process can significantly influence non-executive director behaviours[3]. Careful consideration of current practice suggests that new thinking may bring benefits, discussed below.

While networking remains a common method of identifying potential candidates, working with external search firms is growing. Experiences in this regard are mixed. Search firms can bring a measure of independence to the process by identifying and objectively assessing potential candidates against pre-specified criteria. While boards will then use personal networks to vouch for the person, the initial candidacy is independently validated. Directors appointed in this way may be more inclined to provide constructive challenge than those appointed on a favours basis. As one director noted, ‘they’re not being overly influenced by somebody who is close to somebody, you know, the tap on the shoulder sort of stuff’.

External firms can also be helpful in assessing possible interest and fit on a confidential basis before open discussions begin, thus saving any perceived embarrassment on either side should the appointment not proceed. Where the company doesn’t have the capacity internally, an external firm can also assist in working through the appointment process and ensuring that governance and regulatory requirements are met.

However, working with search firms can be expensive and often does not result in identification of more diverse candidates, particularly in a small market such as Ireland. The experiences of a corporate secretary illustrate the dilemma:

> ‘Now, as a plc, you are forced into having to have a recruitment consultant because otherwise you can’t justify it in your annual reporting.…..But I am disappointed because, as I say, I can produce the same list’.

Similarly, another director noted that the board had considered using a search firm but decided instead to use their network, saying ‘we are getting great calibre candidates through. And we wouldn’t have gotten any better had we used a company’.

Sifting out ‘natural challengers’

While the choice between networking and search firms is important, what comes next in the nominations process is arguably even more so. In particular, the need for ‘fit’ is an over-riding consideration for most boards because, as discussed below, board dynamic is critical to effectiveness. A key driver in the nomination process is therefore the existing dynamic on the board[4]. Good boards with an open dynamic look to appoint directors who work collegially to contribute and offer challenge in a supportive way. The comments of these contributors illustrate:

> ‘You need challengers, and they need to be supportive challengers’.
>
> ‘You don’t want really awkward people…. They can be very disruptive and you can spend your time dealing with somebody who has got a particular bee in their bonnet. At the same time, obviously the right thing to do is to have people challenge, and the open and frank board is absolutely the right way to go. Where people are not afraid to say anything, if they need to raise something, they have got the confidence that they can say anything they want’.

However, on less-effective boards, a closed dynamic can distort the requirement for fit, and favour instead directors who are less inclined to challenge[5]. As the discussion paper notes, the Report of the Parliamentary Commission on Banking Standards suggests that there is a 'widespread perception that some “natural challengers” are sifted out by the nominations process’. A key consideration in the process is therefore the health of the existing board dynamic. This prompts the need for a substantive board evaluation process that objectively assesses dynamic and culture, as discussed below.

Section 2: Board Evaluation

There is significant appreciation of the need for regular board evaluation and the potential for this to enhance board effectiveness. In discussing succession planning, two interconnected aspects of board evaluation come to the fore.

First, it is essential that the process adds value. Companies want to invest in an evaluation that goes deeper than a tick-box exercise, the outputs of which will inform the development and practices of the board. Internally managed processes can work well, particularly if a company has relevant expertise around the board table. However, in-house assessments also face a number of challenges including, for example, the time commitment needed and sensitivities around individual performance concerns, in particular that of the chair. Using an external facilitator can help to overcome these issues, but experiences are mixed in this regard. One concern is that many providers use off-the-shelf packages that don’t add real value. As one corporate secretary remarked, ‘I’m a non-believer in the tick-box exercise, which lots of external parties can offer and I don’t think it works very well’. Similarly, a non-executive director noted that there are ‘very mixed views out there about the quality of the evaluators and the process being carried out…. and whether there is value coming out of it’.

A second and related point is the need for board evaluations to focus significantly on board dynamics and culture. There is a growing appreciation of the impact of behaviours on board effectiveness and organisational outcomes, so, while composition and structure are important issues, significant attention needs to be paid to what happens inside the boardroom. This is influenced by a number of factors, among which are both the process by which directors are appointed, discussed above, and the competencies and character they bring to the table[6]. A board evaluation that examines the norms in operation around the table, which are underpinned by the skill of the chair and the approach of the CEO, can yield significant benefit[7]. Aligned to this, individual director assessment that moves past technical knowledge and experience to include emotional intelligence, interpersonal skills, courage and integrity can help to identify areas for improvement.

These issues point to the need for hands-on board evaluation that objectively assesses the quality of the board dynamic as well as the experience, skills and behaviours of members, including in particular those of the chair and CEO. Careful scoping of the evaluation is needed and outputs should demonstrably feed into succession planning, director recruitment, onboarding and board and director development.

Section 3: Pipeline

The Code provides that the board should ‘satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board’. The internal ‘pipeline’ is key and, in managing this, issues around ownership and responsibilities come to the fore.

Scope
The board's pivotal role in managing pipeline has traditionally centred on the appointment of the CEO in light of the critical importance of that role. In many organisations, ownership of the wider internal pipeline remains significantly within management's domain, with the board offering oversight of the process and evaluating only the most senior executives, guided by the CEO's assessment. However, trends are moving toward increased involvement of the board and its committees in assessing deeper layers of the talent pool through a variety of channels. Alongside traditional approaches such as having managers present to the board, initiatives might include 'deep dives' that bring directors into contact with managers below the senior levels; site visits; direction from the board as to the specific leadership skills required; and participation in talent assessment reviews, including interviewing managers. The spread of responsibilities and the different approaches to managing pipeline suggest a need for increased clarity and a consistent understanding of the ownership of the various aspects of the process.

The director role
An important consideration in this issue relates to the nature of the non-executive director role itself. Role demands have increased significantly in recent years, and some directors feel that current expectations are unrealistic in light of their part-time role[8]. Care is needed in considering the role of the board in managing pipeline, and one director, for example, questioned the idea of 'delving into HR functions', asking 'where do you stop?'.

Equally, there has not been the same focus on the role of the executive director, and in particular how this differs from that of a manager. Stepping on to the board requires executives to step back and take a different perspective, one that overrides departmental or role specific priorities and places the best interests of the organisation first. This transition is not always adequately recognised, as this director explained:

> 'the way you operate as an executive is very different to how you need to operate as a board director and I think maybe that training, moving from one hat into the next, is not that clear'.

Appropriate training and guidance in making the transition from management to board are essential to ensure that internal candidates are board-ready.

Section 4: Diversity
Boardroom diversity is a key issue for companies and their boards. While the UK Corporate Governance Code notes that diversity 'includes, but is not limited to, gender and race', much of the focus in recent years has been on gender, and many stakeholders are keen to make progress in this area. One corporate secretary noted, for example, that his organisation is 'committed to the 30% Club, so we will be putting more females on our board'. Similarly, a director of another company said 'I am a member of a plc that has an all-male board, but diversity is on our agenda'. In examining ways to promote greater diversity, a number of considerations are noted:

Targets
While quotas and targets are not universally accepted, there is significant recognition that they have been successful catalysts for change. An increased focus on ensuring that more women progress up through the executive ranks and into the top positions is needed, and targets or quotas could be helpful in this regard. In Canada, for example, companies are now required to disclose their targets for women in executive positions as well as on the board, and if they have not adopted targets, to explain why they have not done so[9]. There is merit in this type of approach, and initiatives that encourage setting targets for female representation on the senior management team as well as the board warrant consideration.

Candidate Pool

Many directors are unconvinced by commonly cited arguments suggesting a shortage of able female candidates. For example, one director noted that women perform strongly in many of the key skills and traits needed around the board table, including team-working, emotional intelligence and interpersonal skills. Another suggested that 'the board needs to think outside the box when they are trying to get diversity'. A key message is the need to shift mind-sets in this regard.

The criteria used to identify potential candidates can at times be a significant barrier to increasing board diversity, and two points stand out here. The first is a traditional view that directors must have CEO or senior executive experience if they are to add value around the table. This immediately limits the potential pool of candidates, and the diversity of that pool[10]. The second is that many companies prefer directors with prior board experience. But in Ireland, for example, only 12.7% of ISEQ board directors are women[11], so a preference for prior experience naturally limits the pool further. Whilst formal corporate governance education and director development programmes are helpful, they are not seen as a replacement for hands-on boardroom experience.

This suggests that a further review of the process for identifying potential candidates would be helpful. In particular, continued emphasis on broadening the criteria applied may encourage companies to re-assess how different directors may add value. In addition, an increased investment in onboarding directors, including those who do not have prior relevant experience, would help to overcome concerns. One contributor suggested, for example, that the Senior Independent Director could mentor a new director to provide support through the transition period.

Alongside these issues, contributors note that women are not well represented in some sectors, making gender parity more difficult to achieve. Solutions often require the concerted efforts of a range of stakeholders, and many companies actively sponsor initiatives aimed at increasing female representation in these areas. Explicitly addressing this issue in developing succession plans and managing pipeline is helpful.

Dynamics and diversity

As discussed above, the dynamic on any board is central to its effectiveness and is actively protected when appointing new directors. This can lead to wariness in embracing the change that diversity brings. The comments of this director illustrate:

> 'Women change the dynamic of the discussion, and people aren't comfortable with dynamics being changed, and we under-appreciate that…...And actually the gender piece influences dynamic for the better I think sometimes……. maybe there's not enough understanding of that'.

Initiatives to increase understanding of board dynamics in general, and the positive impact of diversity in particular, may encourage boards to move more quickly on this issue.

Communication

Boards are conscious of the need to be seen to appoint female directors but the real benefit of doing so is not fully embraced by some. As one director remarked 'there is still bias and cynicism out there. Actually, even some of the people who [publically] support the 30% club don't think it's a good idea'.

Continued and increased emphasis on the links between strategy and diversity would be helpful in moving the discussion past a numbers game. The shift in purchasing power to women, alongside the power of the consumer voice through modern technology, suggests that many businesses can gain significantly by having female input at the decision-making table, and being visible in doing so. As one director noted, 'women are customers, they buy, they are an important part of the business...... if you don't have at your board that representation then you're missing out in your strategy'. Further comments elucidate the point:

> 'If you look at who's buying, what they are buying, because ultimately that's what this is about, then you are missing a trick in your strategy if you don't have that coming in to play. And in some ways, the discussion isn't sufficient around that, it's got too much caught into 'boys and girls', golf club stuff, rugby club stuff, all of that, and it needs to move much more into the strategy side.'

As with any change programme, a critical element is communication, and a continued emphasis on communicating the strategic benefits of diversity is therefore important. Having chairs and other directors tell the 'story' of how their boards moved towards diversity, and the value gained by doing so, would be helpful in changing mind-sets and encouraging others to follow suit.

CONCLUSIONS

Board succession planning that helps to develop value-add boards and support long-term organisational success is critical. In response to issues raised in the FRC's discussion paper on this topic, a number of aspects of the process warrant consideration. These include the need for greater clarity around the role and composition of the nominations committee; increased focus on the quality of board dynamic and how this informs succession planning and director selection; re-assessment of the criteria used for identifying potential candidates; initiatives to support the promotion of female managers through to top executive ranks and also into roles as chair; and continued communication of the strategic benefits of diversity.

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Notes

[1] Deloitte (2015). Women in the boardroom: A global perspective. At: www2.deloitte.com/women-in-the-boardroom.

[2],[11] Women on Boards Davies Review: Five year Summary (2015). At: thedaviesreview.com

[3] Parliamentary Commission on Banking Standards (2013). Changing Banking for Good Vol 1, London; Also see Halton, M. (2014), noted below.

[4], [8], [10] Halton, M. (2014). Effective Board Behaviours: The Role of Bank Non-Executive Directors in Ireland and Canada. PhD Thesis, University College Dublin, Ireland.

[5] Halton, M. (2013) 'Board behaviours: Bringing challenge in the bank boardroom', International Journal of Disclosure and Governance, 10, pp. 422-441.

[6] See Leblanc, R.W., (2003). Boards of directors: An inside view. PhD Thesis. York University, Toronto, Canada; Halton, M. (2014), noted above; Roberts, J., McNulty, T. and Stiles, P. (2005) 'Beyond Agency Conceptions of the Work of the Non-Executive Director; Creating Accountability in the Boardroom', British Journal of Management, 16 (special issue), pp. S5-S26.

[7] Halton, M. (2016) in *The Handbook of Board Governance*: *A Comprehensive Guide for Public, Private and Not for Profit Board Members.* Ed: LeBlanc, R. Wiley, Canada.

[9] Ontario Securities Commission, (2014). Amendment Instrument for National Instrument 58-101 Disclosure of Corporate Governance Practices 1