



Audit Committee Institute

On the 2018 Nomination Committee agenda

Tasked principally with hiring the right CEO and getting the right mix of experience, skills and knowledge around the boardroom table, the nomination committee has a vital role to fulfil. Yet, for many years the nomination committee has in many ways been the poor relation of the traditional main board committees. It hasn't received the regulatory attention of the audit committee, nor attracted the media profile of the remuneration committee.

However, nomination committees are now in the firing line with investors, the media, activists, proxy advisors and others looking to hold the committee to account for a wide range of issues including board skills and diversity, performance, succession planning (executive and non-executive), independence, tenure, over-boarding and disclosure.

Drawing on insights from our conversations with board chairs, nomination committee members and company secretaries over the past twelve months, we have highlighted ten issues that, in our opinion, nomination committees should keep in mind as they approach and execute their 2018 agendas:

1. **Looking ahead:** The number one item on the nomination committee agenda is the alignment of boardroom talent with the corporate strategy, both for the short and long-term. Whether it's addressing a gap around technology or finding people who have international experience, talent needs to be part of the strategy discussion. Boardroom composition and succession should start with clarity over the company strategy and a clear view of the needs of the business over a range of time horizons, closely followed by an examination of the skills gaps in relation to those needs. Before developing plans for long-term succession, use skills matrices to identify current and future skills gaps and think about the time requirements, the role of ongoing professional development and the output from the annual board evaluation and individual performance exercise. Think about both 'business as usual' and emergency scenarios.

Nomination committees also need to look ahead in order to understand when individuals are due

to (or likely to) leave the board. Scenarios where a number of directors are planning to leave at the same time, or are required to rotate off the board, need handling carefully both in terms of disruption and corporate memory, but also in terms of managing investor expectations.

Finally, when considering CEO succession, be wary of looking to clone the current CEO. 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. Ensure a comprehensive review is undertaken by the committee of the role description and skills requirements.

2. **Plan for increasingly active investors:** In an environment where company directors face annual election, institutional investors are increasingly using targeted voting practices to register their displeasure at particular governance practices – whether that be voting against the re-election of the remuneration committee chair to register a perceived unwillingness to change executive pay arrangements or against the audit committee chair in the light of accounting irregularities, or a failure to adhere to perceived best practice. In particular, expect proxy agencies to recommend voting against the nomination committee chair where: the roles of the chief executive and chair have not been split; where a senior independent director has not been appointed; where the board has not conducted an externally facilitated evaluation of its effectiveness within the past three years; or where an individual who has a significant conflict of interest, or whose past actions demonstrated a lack of integrity or inability to

represent shareholder interests is nominated (or re-nominated) to the board. Large institutional investors are also using their voting powers to reduce the number of over-boarded directors on boards as they believe directors sitting on too many boards do not have time to adequately conduct management oversight - [Big Investors Want Directors to Stop Sitting on So Many Boards](#) (Wall Street Journal, September 26, 2017)

When directors rotate off a board, whether planned or unexpectedly, nomination committees need to look at board composition in the round, what the departure may mean for the board today and in the future, and how best to communicate the changes to shareholders and other stakeholders.

- 3. 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? Diversity is not just about race, gender, sexual orientation and disability, important though they are. It's also about the richness of the board as a whole and the combined contribution of a group of people with different skills and perspectives to offer. People with different experiences, backgrounds and life-styles 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. Consider using psychometric profiling to assess the emotional intelligence of existing and incoming board members. A chairman that understands the differences between board members and how they approach any given situation will be better placed to harness their skills and attributes and ensure that the board as a whole is greater than the sum of its parts.

Closely linked with diversity is the breadth of the talent pool from which new board members are sought. Has sufficient attention been given to recruiting directors with backgrounds in the third sector, academia and government, as well as entrepreneurs and those from family businesses?

Challenge recruitment firms to provide a more diverse list of candidates and be specific about the skills and attributes required. Nomination committees that are themselves diverse, are likely to be more open to bringing in others from more diverse backgrounds.

- 4. Challenge conventional wisdom:** Rapid technological change and new disruptive business models challenge the more traditional approaches of many established businesses. Companies need to consider the impact on their board and to look at a wider pool of candidates in order to identify people with the skills needed for them to meet the challenges they face in this new environment.

Is the 20th century paradigm of filling boards with directors with 'big company' experience still relevant in an age where an understanding of 'new' technology and the agility to manage the consequential opportunities and risks are vital to success? Are today's boards lacking executive currency, youth and/or IT literacy? Individuals with deep technological expertise can be hired at an executive level, but boards still need to be able to 'ask the right questions' and just as important, 'understand the answers'. It is always desirable to find individuals with specific skills who are also capable of contributing across the range of issues the board faces – not least because the board as a whole is responsible for all decisions, regardless of the expertise or knowledge of an individual director in that area – but have the risks around inexperience been overstated? Is there a role on (or as an advisor to) the board for the bright young Turks of the technology world - if not for the usual three terms of three years, then perhaps for a shorter term?

Consider looking beyond the 'usual suspects' to find people with different experiences and backgrounds – including those who have not served on a listed company board before. With appropriate induction, mentoring and coaching, new directors should be able to adapt reasonably quickly. Alternatively, consider the use of an advisory body – composed of independent individuals with expertise in specific fields - to advise the board on areas such as technology and innovation. Being less onerous in terms of time commitment and legal responsibilities, such roles might be more attractive to younger less experienced individuals.

- 5. Consider the breadth of the committee's remit:** Do the nomination committee terms of reference reflect the actual role carried out by the committee? Is the committee's role restricted to leading the process for board appointments or does it extend as far as executive and senior employee succession and talent management? What role does the committee play with regard to the annual board evaluation, induction training and continuous development? Does the committee have a remit for other governance matters (as is increasingly common in North America)?

There are growing calls for boards (through their nomination committees) to take some responsibility for ensuring there is adequate 'bench strength' within executive management as well as the traditional role of ensuring potential future board members are being identified and developed. If the committee does involve itself in the appointment process of those below board level, care should be taken to ensure the line between oversight and management isn't breached as CEOs will, quite naturally, expect to take responsibility for appointing their own teams.

6. **Examine the executive pipeline:** Developing executives so that they are 'board ready' is a challenge for all companies. Does the nomination committee have adequate visibility over the executive pipeline? Are there internal candidates for board positions, how can board members help with their development needs (e.g., through mentoring) and how will the board carefully manage any unsuccessful internal board candidates?

One way of assessing the top talent within a company is for nomination committee members (and other non-executive directors) to have one-on-one conversations with the key players in the business to gain a better understanding of the culture, strategy, key risks, areas of concern etc., and to get to know the leaders outside of the formality of the boardroom. Sit down with the key people in their 'natural habitat,' without an agenda. Just visit them in their office and have a conversation about things that are on their radar ... or yours.

Board-level skills can be developed through executives taking on roles on subsidiary boards or as non-executive directors elsewhere. This can benefit both the companies involved and the individual, however the challenges of performing a board role whilst maintaining an executive career should not be underestimated – particularly where the companies concerned have concurrent year-ends.

7. **Take account of wider stakeholder perspectives:** When recruiting any director, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria. Given the significant influence that a company's key stakeholders have on its future prospects and its licence to operate, the board's knowledge and understanding of the interests of those stakeholders should be among the factors that are considered when assessing the overall composition and balance of the board and whether there is a need to recruit new directors. It will be for the board to decide how much weight should be given to these factors.

There are two broad approaches that boards could consider: reserving one or more board positions for directors drawn from a stakeholder group, such as the workforce; and extending the selection criteria and search methods for non-executive directors to identify individuals with relevant experience or understanding of one or more stakeholder groups. Both these approaches have their merits and they need not be mutually exclusive. Even when a company considers that one or more individuals should be appointed specifically in order to bring the perspective of a particular group to the board's discussions, there may be benefits in having other directors with experience of the same or other stakeholders. This can reduce the risk of the board becoming over-reliant on individual directors, or of other groups of stakeholders being inadvertently overlooked.

Further guidance on how boards might ensure they understand and weigh up the interests of their key stakeholders when taking strategic decisions is set out in the joint ICSA and Investment Association publication [The Stakeholder Voice in Board Decision Making](#)

8. **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. Does the nomination committee explicitly consider culture and values when developing its succession plans and whether potential candidates exhibit the desired culture? How does the nomination committee develop an understanding of a candidate's cultural fit and the impact they have had in other organisations? Similarly, if the company needs to change its culture, how might succession planning assist and take into account the journey required to achieve the desired culture?

Where the nomination committees takes some responsibility for ensuring there is adequate 'bench strength' within executive management, how does the committee develop an understanding of whether executive management are living the desired culture and how does that align with progress and promotion?

9. **Be transparent:** 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. Indeed, the

FRC's Feedback Statement on their UK Board Succession planning discussion paper notes that notwithstanding boards' natural caution about the potential commercial and personal sensitivity when reporting on succession plans, investors felt that the quality of reporting could be greatly improved. Annual reporting can explain clearly the system the board uses to maintain good succession planning practices, and their oversight of succession, for example: how far ahead they look, how they search, select and appoint new candidates, and what sort of skills, experience and expertise are needed.

Nomination committees should also consider how best to report on the link between strategy and succession planning as investors noted that they wish to understand the nature of the skills and experience a board will need in the future, how the company intends to make this transition and the risks associated with not having the right people in place. The inclusion of targets and metrics were also considered useful. Do the director biographies focus on the skills and experience brought to the board rather than their prior employment history?

Furthermore, the FRC Feedback Statement notes that investors felt that current disclosure about board evaluation is insufficient: with most companies reporting simply that they undertook a board evaluation and that the board is operating effectively. More helpful is to disclose what the evaluation looked at, any areas for development identified, and the future action plan (in general terms). It is important that board evaluation does not only focus on the effectiveness of the current board in dealing with today's challenges, but also gives insight to the needs of the future board in the context of the company's strategy.

10. Composition and chairmanship: The composition of a nomination committee will depend on the particular circumstances of the company and its future strategy. Experience of HR, talent management and recruitment are beneficial, but the number of specialists available will naturally be constrained by the size of the company (and the board itself). Where necessary, knowledge and capability gaps can be filled (in part) by expertise from within the company (head of HR, head of talent) and/or external recruitment specialists (head hunters). It is important to understand the CEO's views, particularly on internal talent.

While smaller boards tend to have all their non-executive directors as members of the nomination committee, this is not always possible or even desirable for larger boards. In such circumstances, steps should be taken to ensure appropriate coordination and dialogue takes place between board committees, and in particular between the nomination committee and the remuneration committee – both of which need a grasp of performance and reward.

Historically, nomination committees have been chaired by the chair of the board (except when the nomination committee is dealing with the appointment of their own successor, when it is led by the senior independent director (SID)). However, boards and nomination committees might review this in the light of the expanding nomination committee remit and the demands on the board chair's time. If not chaired by the chair of the board, then the SID is the most logical candidate for the role. Whomever is chosen to chair the committee, it is essential that the chair of the board oversees board succession as they are responsible for board leadership and ensuring every aspect of its effectiveness.

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