

# Succession planning

## *Board composition*

Boards have to plan for orderly succession and renewal as well as be prepared for everything from sudden departure to sudden illness or death of a board member or chief executive officer. It is important to understand that the disruption that occurs when companies change their CEOs and chairs in too rapid succession takes a long time to repair.

Succession planning enables an organisation to refresh its leaders in order to continue meeting the challenges of a constantly changing business environment. While it is usually discussed in terms of CEOs and senior executives, succession planning is equally beneficial for boards. The aim is to have the right person able to fill a vacancy at the right time. The ongoing nature of this planning means that the board has the opportunity to manage its future needs.

Succession planning is closely connected with the processes for selection, appointment and appraisal of directors and executives. The ASX Corporate Governance Council (ASXCGC) advises that board renewal is critical to performance. Specifically, in Recommendation 2.1 of the *Corporate Governance Principles and Recommendations 3e* (2014), the ASXCGC recommends that a nomination committee be established to undertake the following activities:

- *“Board succession planning generally;*
- *Induction and continuing professional development programs for directors;*
- *The development and implementation of a process for evaluating the performance of the board, its committees and directors;*
- *The appointment and re-election of directors;*
- *The process for recruiting a new director, including evaluating the balance of skills, knowledge, experience, independence and diversity on the board and, in the light of this evaluation, preparing a description of the role and capabilities required for a particular appointment; and*
- *Ensuring there are plans in place to manage the succession of the CEO and other senior executives.”*

Of note, this recommendation provides that the nomination committee, or the whole board in the absence of such a committee, should focus on succession planning for board, CEO and other senior executives.

## Succession planning for the board

In medium to large organisations, succession planning has become strategically important to Australian boards due to the high average age of directors at 57 years old<sup>2</sup> (and hence a high number of upcoming retirements) and a shortening of the average tenure of directors, which is now 6 years for non-executive directors in ASX 100 boards and 5.5 years in ASX 101-200 boards.<sup>3</sup> Governance trends such as board performance appraisals and transparency of selection policies reinforce the idea that an organisation must have the optimal mix of people, skills and knowledge to ensure its continued success.

The skills, knowledge and experience required to effectively steer an organisation will change over time in response to market developments, opportunities and challenges. Board succession planning allows directors to match the organisation's future needs based on long-term vision with the best qualified directors available.

A regular skills audit of the current board and comparison with future needs will highlight any gaps and assist in targeting succession plans. Indeed, the ASXCGC's third edition of the *Corporate Governance Principles and Recommendations 3e* (2014) specifically introduced a new recommendation 2.2 which states:

*“A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.”*

It is recommended that boards of larger organisations should maintain a list of potential candidates and monitor it regularly. The availability of highly sought after directors will vary so directors should keep in touch with all potential candidates. Larger organisations might have ongoing relationships with executive search firms to help in this process.

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## Succession planning for the chair

The chair's role should be included in succession plans. Often, the incumbent's retirement date is announced well in advance to allow the board to plan selection and appointment of the new chair. There are, however, some circumstances where a sudden departure may occur, for example death or resignation. This may affect market confidence and the share price so being able to communicate policies and procedures will minimise negative consequences.

Common ways in which boards deal with chair succession are to appoint a deputy chair, identify likely successors from within the board or to appoint a new director with the expectation that they will become chair within a specified time horizon. The advantages of these methods are that the new chair is already familiar with the organisation and has hopefully gained the respect of the other directors by the time they become chair. However, if poorly handled, having an 'heir apparent' may alienate the other directors.

For organisations which have performed poorly, often appointing a new chair from outside the existing board can be used as a signal to shareholders and other stakeholders that considerable change can be expected, including significant change to the board.

<sup>2</sup> Lumsden A and Knight L, 'ASX 200 are getting younger', *CorrsChambersWestgarth News*, 1 May 2015, [www.corrs.com.au/news/asx-200-boards-are-getting-younger], viewed 22 June 2016.

<sup>3</sup> Australian Council of Superannuation Investors (ACSI), *Board Composition and Non-Executive Director Pay in ASX 200 Companies*, ACSI, 2015, p 22.

### Succession planning for the CEO and senior executives

Boards are more familiar with succession planning for CEOs and senior executives. With respect to CEO succession, this is important due to the high turnover of CEOs in Australian companies, with the average tenure of CEOs in 2014 being 5 years, which is up from 2013 when it was 3.9 years.<sup>6</sup> Again the skills and knowledge needed by the executive team to drive the organisation forward will change over time, so succession planning must be a regular agenda item.

The succession plans for the CEO and senior executives should consider short- and long-term scenarios. In the short term, it must be clear to everyone who will step in to manage the organisation when the CEO takes planned or unplanned leave and in times of crisis such as the immediate unexpected departure of the CEO. Appointments in the short-term are acting appointments.

Long-term succession planning concerns permanently filling a vacancy when the current CEO leaves. Vacancies can be unexpected or be known well in advance.

There are in essence two options to long term CEO succession planning – making an internal or external appointment. Most boards of larger organisations keep both options open, but may have a preference for an internal or external appointment. Smaller organisations often lack the depth in the senior management team to have even one, let alone a number of potential internal candidates who are suitable for the CEO position.

The advantage of internal appointments is that the successor is already familiar with the organisation so can step up immediately. Boards should also regularly review with the CEO the performance and development plans of potential CEO candidates to ensure that they are gaining appropriate skills, knowledge and experience to be a CEO. A good way for the board to monitor or evaluate potential internal CEO candidates is to occasionally invite the senior executives to present to the board.

While it is by no means a settled issue, current evidence suggests that internal appointments are on average more likely to outperform external appointments, are less often forced out of office and have slightly longer tenures than external appointments.

External appoints are often made when the board wishes to significantly change the strategy and culture of the organisation. Often in these circumstances the company will be under performing. External appointments are often made on the basis that the board wishes to see major change, often starting with the composition of the senior management team and the portfolio of businesses owned by the company. While such change is often necessary, there is potential to alienate key staff, possibly force them out of the organisation and in doing so decrease confidence in the organisation by shareholders and other key stakeholders.

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<sup>6</sup> Davidson V, Ballard J, Karlsson P O and Nielson G L, *15th Annual CEO Succession Study: The value of getting CEO succession right*, strategy&PwC, 2015.

## Succession planning in a family company?

There are succession and transition planning issues specific to family businesses. First is the question of whether succession by a family member is the right option for the business. Commercial implications need to be balanced against the desire to keep control in the family. Second is the possible need to consider management and ownership transitions separately.

Well before retirement family business owners need to answer these key questions

- Does your preferred successor really want to take over?
- Does he or she possess the necessary skills and qualifications?
- Is there someone else within or outside the business who would be a better choice?
- Will nominating your preferred successor create conflict – for example sibling rivalry or conflict with other employees?
- Will family succession provide sufficiently for your future?
- Are there are ownership issues to resolve; and
- Is the current business structure appropriate for the future?

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