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Board Development and Director Succession Planning in the Age of Shareholder Activism, Engagement and Stewardship

** A modified version of this article was recently featured in a publication for public company directors, CEOs and GCs.*

The intensifying spotlight turned on boards of directors and management teams by investors prompts a fresh look at how public companies approach board development, director succession planning and refreshment in advance of an activist attack, shareholder unrest or a crisis that results in heightened scrutiny. As the New Paradigm of corporate governance takes hold, the major index fund asset managers, many actively managed funds and the two largest proxy advisory firms have each formally incorporated questions relating to board quality and practices into their direct engagements with companies, voting policies and how they evaluate a proxy contest to remove or replace existing board members and CEOs. In addition, activist hedge funds will re-frame matters of corporate strategy and performance into referendums on board quality, questioning whether the board had the right skillsets and practices in place to oversee important business decisions. Accordingly, public companies are increasingly being called upon to consider and prioritize the following:

- **Deciding Board Development Matters**
- **Playing Offense in Board Development**
- **Self-Assessing for the Future, Planning Ahead and Building the Pipeline**
- **The Value of a Balanced Board**
- **Board Diversity and Expanding the Pool**
- **Preserving & Strengthening Board Culture**
- **Substantive Evaluations vs. Hard-Wired Refreshment**
- **Managing Lengthy Tenure**
- **Special Expertise**
- **Better Onboarding, Director Education and Expert Tutorials**
- **Tailoring Governance Processes and Documents**
- **Considering Rotation of Key Board Positions and Committee Assignments**
- **Engaging with Investors**

Examples of renewed investor and proxy advisor interest in such matters include:

- **BlackRock:** "We encourage boards to disclose their views on the mix of competencies, experience, and other qualities required to effectively oversee and guide management in light of the stated long-term strategy of the company…we may vote against…the independent chair or lead independent director, members of the nominating / governance committee, and / or the longest tenured director(s), where we observe…a failure to promote adequate board succession planning."

- **State Street:** "[A] well constituted board of directors, with a balance of skills, expertise, and independence, provides the foundations for a well governed company. We view board quality as a measure of director independence, director succession planning, board diversity, evaluations and refreshment, and company governance practices…boards should continually self-assess the skills and experience of their board members and seek to continually enhance their capabilities by addressing any skill, experience or other gaps."

- **Vanguard:** Commonly asked questions by Vanguard of company leaders and directors include "Based on your company's strategy, what skills and experience are most critical for board members, now and in the future? How does the board plan for evolution and future director selection (that is, for strategic board evolution)?" In analyzing proxy contests and whether to vote for the company's proposed directors or the activist dissident's directors, a key area of focus for Vanguard includes "The quality of the company and dissident board nominees…Are the directors proposed by the dissident (whether the full slate or a subset) well-suited to address the company's needs, and is this a stronger alternative to the current board?"

- **Glass Lewis:** "[W]e may consider recommending shareholders vote against the chair of the nominating committee where the board's failure to ensure the board has directors with relevant experience, either through periodic director assessment or board refreshment, has contributed to a company's poor performance."

- **ISS:** In proxy contests, ISS will squarely assess board composition, and ISS' "Governance QualityScore" measures evaluate the presence of "mechanisms to encourage director refreshment" and board structure to take into account director age, distribution of director tenures, the number of female directors and whether they hold leadership roles. In the context of assessing generally disfavored mandatory director retirement ages, ISS indicates it will nevertheless "scrutinize boards where the average tenure of

> all directors exceeds 15 years for independence from management and for sufficient turnover to ensure that new perspectives are being added to the board."

Federal and state legislation and regulatory mandates are also beginning to target board-related topics, including with respect to board diversity and disclosures concerning board quality and practices. These areas have also been a focus of important third-party initiatives, including those by Focusing Capital on the Long Term (FCLT), the Coalition for Inclusive Capitalism's Embankment Project, the Investor Stewardship Group (ISG), the World Economic Forum International Business Council's support of the New Paradigm, the Commonsense Principles and the Business Roundtable.

Accordingly, company practices are evolving to meet the expectations of more vocal and engaged investors and ensure that the board itself continues to be a strategic asset to the company and the management team. In this new environment, companies may wish to consider some of the considerations and emerging practices outlined below when developing or updating board development and director succession plans, taking into account their own needs, circumstances and investor feedback:

- **Deciding Board Development Matters:** The board may explicitly acknowledge in governance guidelines, board policies and public disclosures the importance of board development and succession planning as part of the company's commitment to strong governance and affirm its belief that such planning will strengthen the board's ability to further the best long-term interests of the company and its shareholders and other stakeholders and achieve the company's purpose.

- **Playing Offense in Board Development:** Especially if the company has been the subject of public controversies, activist attacks or heightened scrutiny, consider potentially favorable "signaling" aspects of changes in board composition and ensure that actions regarding board composition align with the broader narrative and messaging that the company seeks to convey. The company should put itself in a position to present effectively the diverse skills, expertise and attributes of the board as a whole and of individual members and to link those to company-specific needs and risks.

- **Self-Assess for the Future:** Review periodically the board's composition to assess whether it reflects the knowledge, experience, skills and diversity that will best enable the board to fulfill its duties, taking into account the current and future needs of the company, the company's current and future business strategies, industry and competitive landscape, the expectations placed on boards beyond legal requirements and the potential for the company's circumstances to change over time. Consider using a "skills and attribute matrix" to support the board's self-assessment of its composition and consider expanded disclosures.

- **Plan Ahead:** Plan for director succession in advance of retirements over an appropriate time horizon (e.g., at least a two- to five-year timeframe). In advance of retirements, develop a point of view as to what kinds of skills and experiences could be useful to have represented in the boardroom and what skills, backgrounds or networks would be lost in connection with a retiring or departing director.

- **Build the Pipeline:** Maintain a strong pipeline of candidates to consider for membership on the board. This facilitates the orderly identification and selection of new directors and improves the position of the board when faced by demands from activist hedge funds or other third parties for accelerated board refreshment.

- **The Value of a Balanced Board:** Balance board refreshment with retaining institutional knowledge. A variety of backgrounds, ages, tenure, experiences and skills is generally desirable to have in the boardroom. Such variety helps promote board quality, stability and continuity while bringing different perspectives to board discussions without the harm of excessive churn and turnover. A balanced board also preserves the heightened oversight that longer-tenured directors can bring, especially in businesses with long development or product cycles and where institutional and company-specific knowledge and culture matter. Diversity of board tenure can also facilitate mentoring, development and knowledge exchange among directors. For example, more seasoned and experienced members of the board can offer insight and guidance to newer members as newer members share their perspectives and experiences with longer-tenured directors.

- **Board Diversity:** Advance board diversity in the self-assessment, recruitment and nomination process, including, but not limited to, diversity in gender, ethnicity, race, age, experience, geographic location, skills and perspectives. Consider increasing the size of the board to accommodate new talent in advance of an incumbent director's departure, including in the case of highly qualified diverse candidates.

- **Expanding the Pool:** Reflect on the company's processes by which candidates are identified and selected, including the use of professional search firms, director or management networks, third-party databases, investor or stakeholder recommendations and other sources to find quality candidates. Consider whether to expand the pool of candidates from which board members may be chosen beyond historical criteria.

- **Board Culture Matters:** Discuss what kind of board culture the company wishes to promote and how to foster the right board culture. A vibrant board culture of constructive support and engaged challenge is a valuable asset to management and investors, a source of competitive advantage and vital to the creation and protection of long-term value. Strong cultures will help the board and management team navigate stress, pressure, transition and crisis. Consider the positive or negative impact on board culture if a particular director candidate were to join the board, leveraging appropriate diligence, reference checks and interviews.

- **Substantive Evaluations vs. Hard-Wired Refreshment:** Consider whether regular, substantive self-evaluation is superior to hard-wired mechanisms to promote evolution of the board and its practices. Evaluate retirement ages, term limits, waivers or hybrid approaches combining age and tenure (or other measures) carefully. Discuss whether existing board, committee and director evaluation processes are check-the-box exercises or substantive exercises that inform board roles, succession planning and refreshment objectives. Assess whether there are ways to incorporate the results of the board's self-evaluations into director development, coaching, succession and (re)nomination decisions, including reviewing the ongoing contribution of incumbent directors to the overall effectiveness of the board as a whole and identifying helpful methods for enhancing such contributions.

- **Managing Lengthy Tenure:** Where there are many long-tenured directors, assess whether to bring the average tenure of the board as a whole in line with the policies of the company's major shareholders over time or peer averages through a combination of adding new directors and anticipating future director retirements and decide whether to set a target date (which may or may not be externally disclosed). Discuss whether advisory directors or directors emeritus would be useful and appropriate to facilitate board succession.

- **Special Expertise:** Where special or "single issue" expertise is desired, evaluate if the board is really best served by adding a new director (who would also have to contribute to discussions not involving the special issue) as opposed to relying on other means, such as hiring expert consultants and advisers, creating an advisory group, improving tutorials and director education or enhancing a management-level function and associated board oversight.

- **Better Onboarding:** Accelerate the ability of newly added directors to get up to speed and contribute quickly from the beginning of his or her term, even while learning about the company and its business. This requires prioritizing strong director orientation and "onboarding" programs, and creating early and repeated opportunities for longer-tenured directors and senior management to get to know new directors. Onboarding is a process that now takes place within the larger context of the unprecedented diversification of directors in background, expertise and outlook.

- **Director Education and Expert Tutorials:** Expand director education, tutorials and retreats involving internal and external experts to ensure that all directors stay apprised of relevant developments, changes in the business environment, competitive threats, business opportunities and the takeover, activist and governance landscape. Especially in complicated, multi-industry and new-technology companies, implement practices to ensure that the directors have the information and expertise they need to respond to disruption, evaluate current strategy and strategize beyond the immediate horizon.

- **Tailor Governance Processes and Documents:** Tailor annual board and committee agendas and workloads, committee charters and corporate governance guidelines and other policies to reflect board priorities and promote effective board and committee functioning.

- **Consider Rotation of Key Board Positions and Committee Assignments Over Time:** Plan for the rotation or succession of board roles over time, including that of the lead director/board chair and the chairs of various committees, and consider whether to rotate committee memberships periodically.

- **Engaging with Investors:** Board strength, composition and practices are now routinely assessed by institutional investors and other stakeholders. Companies are well-served to regularly assess how best to communicate board development and succession plans to investors and the company's progress against them. Companies should also anticipate director-level interactions with major shareholders about these topics and know when and how to involve directors—proactively or upon appropriate request—without encroaching upon management effectiveness.

  When engaging with investors on these matters and considering proactive disclosures, companies should: (1) explain why the company believes the board includes the right set of directors; (2) outline the company's approach for identifying and addressing material gaps in board composition; (3)

carefully explain procedures for ensuring that directors possess the skills required to oversee and direct the course of the company with management; and (4) proactively share how directors contribute, are integrated into strategic planning, guide and oversee the company's strategic choices and assessment of risks, and test and challenge with management business strategies and execution.

Failing to plan ahead on matters of board practices and composition increasingly exposes public companies to opportunistic activism and creates other vulnerabilities. Effective board development and director succession planning holds the promise of facilitating the thoughtful evolution, over time, of board composition and board practices during periods of "peace" rather than stress.

Taking a fresh look at these matters, including associated disclosures, will also help companies strengthen their relationships with major investors and increase the likelihood that investors give the board the benefit of doubt on matters of complex business judgment or where patience is needed before business initiatives bear fruit.

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