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For the CFO Board Member: CEO Succession Planning and Talent Considerations

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Among the board's many important responsibilities is the establishment of an effective and sustainable CEO succession plan. A fully developed succession planning process addresses the selection, development, evaluation and compensation of the CEO. CEO succession planning is only part of the overall talent management process that the board oversees, particularly as it relates to executive leadership. While the executive management team is responsible for implementing the CEO succession plan and the broader talent management process, it is the board's overall responsibility to keep management accountable that appropriate processes are in place.

A poorly managed or an absent CEO succession plan poses risks to organizational performance and shareholder value. There are considerable external pressures from investors and broader stakeholders for greater accountability and transparency regarding CEO succession processes. In addition, the SEC has shown support for shareholder proposals demanding information about, and greater transparency over, CEO succession policies. With talent management moving up on the short list of enterprise-wide risks, it is little surprise that boards are spending more time in this area.

Talent Management

"Talent" can be defined as individuals who are capable of contributing to the success and future of the organization. Talent management involves a strategic path for individuals—from recruiting and attracting to retaining and developing—throughout the organization to facilitate their contribution to the organization's success. Talent management is a strategic matter and should be considered an integral component of the long-term business strategy.

Boards should confirm that the company has an effective and robust talent management program capable of delivering value for shareholders. Talent is one of the five critical governance elements over which the board provides active oversight. Executing active oversight with regard to the five elements—performance, strategy, governance, talent and integrity—cannot be delegated to management. At the core of the framework are risk and culture, which influence the effectiveness of all elements of governance, including talent. In line with this concept, boards should confirm that they maintain a culture that attracts, develops and rewards talent and a strong culture of management accountability.

Talent management is also closely connected to risk management, and should be embedded into risk management processes. Boards should understand inherent talent risks and how management is monitoring, assessing and mitigating them. The board is responsible for setting the tone for treatment of talent and risk management throughout the organization.

CEO Succession Planning

The most explicit role of the board in the talent management process is leading the succession planning processes by evaluating, selecting and determining compensation packages of the CEO. Eighty-seven percent of respondents to the **2011 Board Practices Report: Design, Composition and Function** survey said that the primary responsibility of the CEO succession planning process resides with the board or one of its committees. Eighty-five percent said their boards review CEO succession plans at least once a year.

Because the success of an organization depends heavily on the performance of its leaders, CEO succession activities should be an ongoing priority and should appear on the board's agenda regularly. Boards should actively oversee the processes used by management in its role of determining that:

- Risks are mitigated.

- Potential talent is identified and continually assessed in accordance with the required skills and evolving circumstances of the company, industry and business environment.
- Board members have the opportunity to interact with potential CEO successors.
- The transition of the incumbent CEO is as smooth as possible.

The Board's Role in Developing the Pipeline

An effective CEO succession process identifies a pool of talented candidates with the skills and experience needed to fill the position. When considering development of the leadership pipeline, boards should review the processes by which executive management is cultivated inside the company or recruited externally. Whether the pool of candidates is internal, external or both will differ by company and situation.

Business continuity, lower risks and fewer expenses may sometimes be associated with internal developed executives. Boards tend to have more exposure to internal candidates than they do to external candidates. They can develop internal leaders, interact and communicate with insiders and assess their performance in action.

External candidates, on the other hand, provide a fresh perspective and often have diverse experiences and knowledge. To identify capable candidates, boards should assess internal candidates against the external marketplace regardless of whether the intention is to consider internal or external candidates. Executive recruiters and advisers can help identify candidates and compare them objectively. Ultimately, the pipeline of candidates, whether internal or external, should be measured against the company's overall vision for the future.

Talent Oversight Model

The Deloitte Governance Framework: Framing the Future of Corporate Governance provides a model of regulatory requirements and leading practices for boards to consider in executing their responsibilities. Underlying each governance element are four attributes to help measure effectiveness: skills and knowledge, process, information and behavior. A board's maturity with regard to each element may range from low to high, but it should take the time to assess how well it believes it is performing.

Attributes of a Highly Functioning Board

Below are attributes that are important to a highly functioning board and examples of how the board would exhibit those attributes.

Skills and knowledge—The board understands the attributes of successful leaders and how to apply them to the organization and its strategic plans; has experience developing leadership pipelines in organizations of similar size and scale; understands the mechanics of the company's compensations plans and the risks inherent in the plans.

Process—The board performs the following functions:

- Appoints the CEO and oversees the CEO's development, goal-setting and compensation.
- Approves and monitors compensation performance metrics for the CEO.
- Oversees CEO compensation and transparent disclosure of executive compensation to stakeholders.
- Ensures development of executive succession plans that contemplate various scenarios.
- Collaborates with management to develop and adopt a compensation philosophy for the organization.
- Meets periodically with executive leadership, including risk and HR, to understand organizational compensation plans, talent pipeline and underlying risks.
- Monitors external stakeholder considerations related to executive management and compensation.

Information—The board obtains independent views and peer company benchmarks of compensation plans proposed by management; has access to and receives periodic reports related to compensation plans, including internal audit and other reports; monitors marketplace developments.

Behavior—The board leadership takes responsibility for the development of the CEO; appropriately supports and mentors the CEO; develops and maintains relationships with other key executives, especially those with potential to succeed the CEO.

The Benefits of a CEO Succession Plan

A fully developed CEO succession plan can contribute to good governance and management of an organization. Poor planning can result in unnecessary costs, increased risk and the loss of investor confidence. If people are a company's greatest asset, then oversight of talent management and CEO succession planning should be considered an investment in those assets. When a robust plan provides for a smooth CEO transition—whether a company is faced with a planned or an emergency succession—it will yield returns for stakeholders.

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Questions? Write to **Deloitte CFO Editor**

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