Report of the

NACD Blue Ribbon Commission on TALENT DEVELOPMENT

A Boardroom Imperative

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Gregory Lau and Mary Pat McCarthy, Co-Chairs

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Acknowledgments

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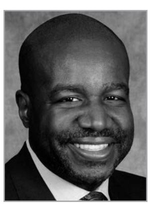

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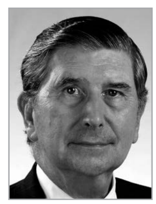

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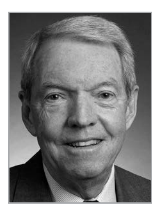

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LETTER FROM THE CO-CHAIRS

Why Talent Is a Critical Issue

From the board's perspective—and the investor's—few things in business are more rewarding than the execution of a winning strategy by a successful executive team. Having the right leadership in place to drive strategy, manage risk, and create long-term value is essential to an enterprise.

Far less obvious, however, is what it takes to find, groom, and retain the talent that is required—at the top and down through the ranks—to keep the company on track. This is particularly true in a business environment that continues to grow more complex, unpredictable, globalized, and competitive by the day.

Clearly, the talent management challenge goes well beyond CEO succession. Do the company's talent development efforts support its strategy and fit its risk profile? Is there a clear view of management's bench strength—and any gaps in the pipeline—in critical areas of the business? Does the company understand what its talent needs will be in three years—or five years—in a landscape that may look very different from today's?

The reasons to move talent risk and development higher on board agendas are difficult to ignore:

- The gap between talent needs and talent resources—particularly in light of how globalization, digitization, and demographic shifts are reshaping business—continues to widen.[1]
- Studies clearly point to higher success rates for CEOs recruited from within the organization[2]—yet, designing talent development and compensation programs that effectively nurture and retain home-grown talent is a major challenge for most companies.
- Human capital can represent half—or more—of a company's operating costs.[3]
- The pool of experienced senior management and executives has begun to shrink (reversing a decades-long expansion).[4]

This report draws on the experiences and insights of our Blue Ribbon Commission members and research from the National Association of Corporate Directors (NACD), as well as the thoughtful work and writings of others in the business, human resources (HR), and governance arenas. With a focus on the board's responsibility to help ensure that the company is appropriately developing talent to meet expected future needs, this report addresses:

- The role of the board and its standing committees in overseeing talent development and retention.
- Elements of an effective talent development program—from hiring philosophy, sourcing, and onboarding, to the role of HR and business units.
- Ongoing assessment and reporting on the company's talent development efforts.
- CEO and C-level succession—the culmination of an effective talent pipeline.

These and other key elements are highlighted throughout—and at the end of—this report in the Ten Imperatives for Effective Oversight of Talent Development Programs.

Of course, no single approach will fit every organization, but we believe that this report can help boards and committees better understand their roles in helping to guide the company's efforts to find and develop the talent it needs to stay competitive and build long-term value.

As one of our commissioners noted: "Success cannot happen without the right talent." Our hope is that this report will inspire and promote more robust discussions in the boardroom aimed at ensuring that the company has the talent it needs—on point and on deck—to make success happen.

Gregory Lau
Mary Pat McCarthy

October 2013

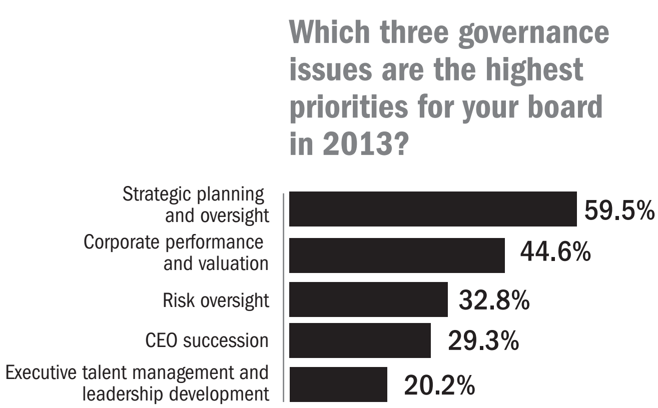
CHAPTER ONE

Prioritizing Talent

Talent is simultaneously one of the most critical risks and one of the greatest sources of opportunity that companies face. Yet, many boards today have only begun to recognize talent development as a foundation for the company's performance and future success.

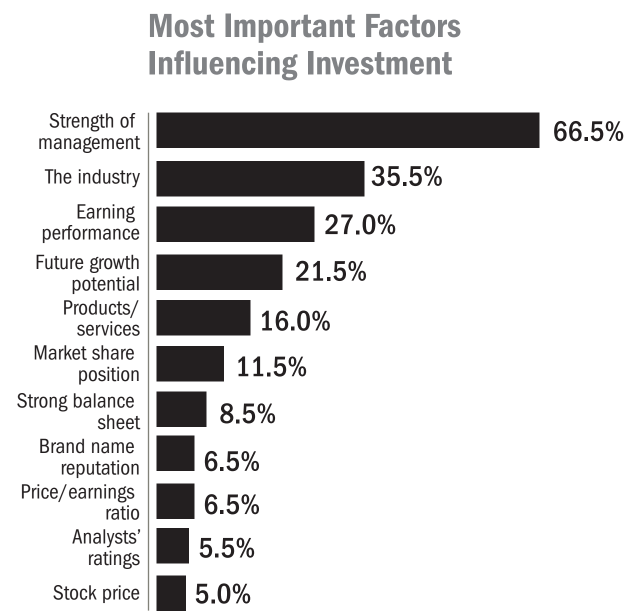
Many boards still hold a fairly narrow view of their role in talent development (i.e., to ensure an effective CEO succession plan is in place). In NACD's latest survey of directors (Figure 1),[5] executive talent management and leadership development ranked fifth in priority of governance issues—behind strategic planning and oversight, corporate performance and valuation, risk oversight, and CEO succession. Although this marks huge strides from just years earlier—in 2008 and 2009, executive talent management languished in 13th and 12th places, respectively—the rapid rise in priority necessitates a plan of action.

Figure 1: 2013–2014 NACD Public Company Governance Survey



The increasing focus on corporate talent is also reflected in the marketplace, with investors and other stakeholders becoming more vocal about the value they place on an organization's human capital. According to a study of equity analysts conducted by Corporate Branding LLC (Figure 2), "strength of management" is the most important factor influencing investment decisions—beating out such factors as "the industry," "earnings performance," and "products and services."[6]

Figure 2: Most Important Factors Influencing Investment



Factors representing less than 5% are not shown.

Source: Research of 200 financial analysts by Corporate Branding, LLC

Yet, more than half of organizations either do not have a workforce plan or that plan only forecasts talent needs for the next year.[7]

Talent, Strategy, and Risk—Inexorably Linked

When assessing the viability of strategic decisions, directors often focus on the financial implications of the various alternatives, while the human components receive less attention. Even the best strategies, however, can be critically undermined by a lack of talent to carry them out.

As noted in the introductory letter, having the right leadership in place to drive strategy, manage risk, and create long-term value is essential to an enterprise. Not only are people with the right skills—the "talent"—crucial to strategy and its successful execution, but when coupled with the right culture they can also allow the company to raise its risk tolerances. With the knowledge that the strategy is supported by the right talent, an organization can leverage this knowledge to more safely adopt a greater risk appetite—which is a powerful advantage for any company, particularly in today's business and risk environment.

IMPERATIVE #1 To meet future challenges, successful organizations establish multi-year, multi-level internal pipelines of talent.

Globalization, technology, political and economic uncertainty, and the demands of increased regulatory compliance have amplified the challenges and potential areas for corporate missteps. Further, as companies search for new growth opportunities, often beyond their core business, having the right talent can make the difference between strategic success and spectacular failure.

Adding Talent to the Dashboard

Unlike quarterly financial results or assets listed on a corporate balance sheet, human capital can be difficult to value, measure, and track in a quantifiable manner. The indirect relationship between talent and financial performance may also cause it to surface less frequently on the board's radar. No doubt, the qualitative nature of talent programs creates hurdles to effectively assessing a company's talent development efforts. As Peter Drucker observed in *The Practice of Management*, what gets measured gets done.[8]

The ability to see and monitor a company's development of human capital—whether on an enterprise risk dashboard or other format—becomes increasingly important as talent moves higher on the board's agenda. Directors will need to ask: Are our talent efforts paying off? Are there gaps in the pipeline? What challenges are on the horizon? As is the case in their oversight of other key risks, directors face the inherent limitation of not being involved in the daily operations of the company. Directors are, therefore, reliant on management to provide information on the progression and growth of all employees, particularly those below the C-level. At many boards, talent development is consequently presented at a very high level, without a dashboard to measure effectiveness. (For an example of a dashboard that includes human capital, see Appendix A.)

Having a clear picture of the company's efforts in talent development—particularly senior management's bench strength—can also help inform stakeholder views of the organization. As noted earlier, despite the comparative lack of quantifiable metrics, talent development and management strength are often critical areas evaluated by investors and financial analysts when assessing a company. In fact, human capital can account for up to 15 percent of an analyst's valuation[9]; yet, absent any insight from the company about its talent development and bench strength, stakeholders are often left to rely on "gut" judgments about a company's executives and talent pool.

In short, it is vital that the board recognize that talent, strategy, and risk are inexorably linked. Talent development should be an integral part of the organization's discussions on strategy and risk that occur throughout the year.

CHAPTER TWO

The Role of the Board and Its Standing Committees

The role of the board in overseeing talent development has, by and large, suffered from a lack of clarity. Understanding the critical role of human capital—and CEO succession planning—in creating long-term growth is a solid first step. Engaging the board and adding value in the company's talent process, without delving "too far" into management and operations, is critical.

IMPERATIVE #2 **Oversight of the company's talent development efforts should be a full board responsibility, with the actual planning owned by management.**

The Role of the Board

As oversight of corporate strategy is a full board responsibility—and execution of that strategy hinges on the company's talent pipeline—this commission recommends that the full board be responsible for oversight of talent development. The actual plan and its execution, however, are owned by management. The role of the board is twofold:

1. Helping to ensure the strength of the organization's ongoing talent development program, and
2. Monitoring the development of identified potential successors for critical roles within the organization through multiple lenses of immediate, three-year, five-year, and longer intervals.

Obviously, directors cannot monitor the development of every employee in an organization, but good communication and reporting from management (see Chapter Four: Assessment and Reporting) can help directors ensure the organization has established an effective program. At a high level, the board should work with management to understand the talent and skills necessary to execute the company's strategy, and the talent development plan required to meet those strategic needs. The work then splits between the board, committees, and management. While the CEO and management ultimately own the development process, the standing board committees can oversee the talent development associated with their respective areas of oversight.

IMPERATIVE #3: **The full board should view human capital through the lens of strategy and risk, with committees providing input to the board on talent development in their respective areas of oversight as appropriate.**

"Talent development is absolutely a full board matter because it is inextricably tied to strategy and risk. There should be reporting metrics to identify talent issues related to strategy implementation."

The Talent Component

Importantly, the board should clearly communicate its expectations for management to continuously focus on the internal development of talent through processes that attract, advance, and retain employees. This ongoing focus will support the goal of having the optimal, vetted talent in all positions throughout the organization.

To reinforce the emphasis on development, the board should request that management include a "talent component" in every strategic initiative presented. Given the company's existing leadership and workforce, is the planned strategy realistic both now and in the future? If not, in what areas of leadership or skill is the company lacking?

In addition to reviewing the talent factor related to every strategic initiative, the board agenda should allocate time—at least annually—to take a deep dive into human capital development.

Another important, and easily overlooked, consideration is whether the skill of talent development resides on the board. Does the board comprise directors with the insight, experience, and objectivity required to effectively oversee the company's talent development efforts—and ultimately determine which executives are best-suited to lead the organization?

IMPERATIVE #4 Directors should request that management provide a talent component in every strategic initiative presented to the board.

Role of the Board's Committees

Just as an institution is built on the flow of talent upward and across the organization, oversight can be viewed as cascading downward. At both the board and committee levels, the discussion about talent must be ongoing and supported by a variety of metrics. Some boards may have a tendency to review talent metrics as part of the risk dialogue. But simply labeling talent as another risk may not be sufficient, particularly if corporate performance has been good and therefore the risk may be categorized as "low."

At the committee level, a traditional connection to talent oversight across the enterprise lies with the compensation committee, which oversees incentives—financial or otherwise—that are designed to drive performance. The nominating and governance committee is also typically involved in analyzing the "bench strength" at senior levels in organizations. The oversight practices of these two committees should be viewed as part of a larger, coordinated system in which talent oversight cascades from the full board to a standing or ad-hoc committee, then to business unit or function leaders.

Each of the committees should have robust discussions with their key management liaisons (or other senior managers as needed) about the talent in their respective area's pipeline. Among the key questions to ask management:

- How is the talent strategy connected to the risk profile?
- How is the company ensuring high levels of employee engagement?
- How is talent development measured? How is management performing based on these metrics?
- Are the business unit or function leaders truly engaged in talent development and performance measurement? As directors, how can we be sure of this?
- For companies with a global presence, how successful is management at replacing expatriates with local nationals?
- How are compensation and other incentives used to drive the company's talent development efforts?
- How are relevant global competitors monitoring talent? Have these methods changed? How are they different from our practices?

IMPERATIVE #5 To ensure that talent receives the necessary time and focus, boards should consider drafting talent oversight and succession planning into official corporate documents.

To ensure that they will receive the necessary time and focus, critical aspects of talent oversight, including bench strength and succession planning, can be drafted into official corporate documents, such as corporate governance guidelines, board and committee charters, or proxy statements. (See Appendix B for examples.) This not only provides clarity regarding ownership of the various aspects of oversight, but also helps ensure that sufficient time will be allocated when the board and committee agendas are planned for the year. ▲

> "An essential role of the board is to oversee executive talent management, culminating in a sustainable process to develop and select the next CEO from within the firm. This is the best way to ensure the long-term viability of the enterprise."

Questions Directors Can Ask to Begin the Discussion on Talent Development:

1. In recent years, has the investment in the talent development program (e.g., human resources, financial commitment) increased, decreased, or stayed the same?
2. Does the organization have a workforce plan that forecasts talent needs?
3. How effective do you think the workforce plan is in meeting immediate and long-term human capital needs?
4. Which talent-related categories are in short supply? Managers? Senior executives? Highly skilled? Low skilled? In what geographic areas?
5. Does senior leadership recognize the strategic importance of HR?
6. Should the most senior HR executive report directly to the CEO?
7. How often is progress on the organization's people strategy communicated to senior management/the board?
8. Does the organization have an executive responsible for talent development within the organization?
9. Does leadership conduct a regular (annual or biannual) talent review process?
10. Does the organization tend to fill critical roles from within or buy talent from outside?

Source: Mercer.

CHAPTER THREE

Components of an Effective Talent Management Program

"Don't neglect long-term investments in talent to save money and generate profits this year."

Talent development programs will differ greatly, depending on the company's size, industry, global reach, and other factors. Yet, all successful talent programs take into consideration such critical elements as hiring philosophy, retention and incentives, and onboarding and mentoring to help employees grow professionally and succeed in their roles.

This chapter is intended to outline the critical components of an effective talent development program, including warning signs of gaps or shortcomings that may need to be addressed—particularly in advance of a leadership transition.

IMPERATIVE #6 **The company's hiring philosophy, employee retention and incentive programs, and corporate culture should all align to support a robust talent pipeline and long-term talent strategy.**

Well-Defined Hiring Philosophy

Talent development programs identify high-performing individuals and invest in their potential to grow as future leaders, as part of the broader plan to resource the organizational talent pipeline. To oversee this process, directors need to understand and agree with the organizational hiring philosophy behind management's human capital predictions. The balance between sourcing talent internally versus externally can be viewed through a lens of "building" versus "buying." If the desire is to build, or rely on internal talent, does management have a long-term plan with commitment and resources to provide training, education, and mentorship? Directors should note whether a gap exists between what the organization states as a hiring philosophy and the actual hiring activity.

The benefits of building talent from within are well documented. Internal development programs allow senior management and the board to watch candidates grow and develop within the organization, thus serving as protracted "interview" periods. Further, studies have shown that companies that build talent internally are nearly twice as likely to view their hiring plans as extremely effective.[10]

Conversely, outside hires can often bring a fresh perspective to the organization. At lower levels of the organization, external hires present a lower risk of disrupting operations and a higher probability of assimilating into the organizational culture. For this reason, this commission recommends that companies consider a pyramid structure of hiring externally: the highest percentage of external hires should be at the lower levels, fewer at the middle, and the least at the top levels of senior management.

Situations may arise that create a need for a company to hire a greater portion of employees from external sources to meet a new challenge, shift strategic direction, or acquire specialized skills that are developed in a more cost-effective manner externally. As previously noted, company size and stage of growth are critical factors in establishing a hiring philosophy. With fewer resources and employees, smaller companies may find it more challenging to rely on the same hiring strategy as a larger company.

Incentives That Encourage Growth and Retention

The design of compensation packages should align with the organization's hiring philosophy (i.e., sourcing internally or externally, retention, and long-term vision). Basing pay plans on what peers offer may seem competitive, but can actually hamper the development of internal talent by ignoring factors unique to the specific company.

Further, compensation plans for managers and business unit leaders can include a portion based on ability to develop and promote internal talent. By clearly aligning with the hiring philosophy, compensation packages can support sustainable growth in the organization.

In assessing the use of incentives around talent development, boards should consider the following:

- Companies focused on internal development can tie executive compensation partially to continuing development plans and increasing levels of contribution.
- Hiring externally may require actualizing certain elements of a pay package from prior employers, which can cause disruptions to internal compensation planning.
- Non-monetary incentives may significantly impact employee satisfaction and engagement, including:
    - The ability to learn and grow professionally.
    - A clear line of career growth and progression within the company.
    - A supervisor that serves as a mentor and encourages employee learning and growth.
    - Opportunities to show initiative and demonstrate leadership.
    - Recognition for continuing successes and promotion based on their potential for future success.
    - Identification with a quality and growth organization.
    - Collaboration with respected colleagues, as well as respect from peers.
    - Alignment with the company's values, ethics, and commitment to corporate responsibility.

The fewer qualitative incentives available, the more likely that compensation will become a bigger factor in a candidate's determination of job satisfaction, and thus his or her decision to join and stay with the organization.

Just as the hiring philosophy affects the design of compensation packages, successful internal development of executive talent can hinge on high-potential employees seeing the company as a place for long-term career growth. To encourage this, some form of compensation that vests or is earned over several years—such as equity—can be used.

The Cost of External Candidates

Studies suggest that outside candidates cost, on average, about 65 percent more than comparable internal candidates as a result of search expenditures and hiring packages. Yet, these external candidates tend to be removed from the job early on— about seven times as often as internal candidates.

Source: The Top Ten Questions About CEO Succession, Mercer.

Ongoing Career Development

Talent oversight does not end with the identification of talent sources and compensation philosophy. Once employees are in the organization, it is critical for the company to provide onboarding, support, continuous learning opportunities, and clear paths to promotion and success. Onboarding programs are necessary for all employees, regardless of level, experience, or whether they are new external recruits or internal promotions. They are also a necessary complement to effective compensation systems.

"Often, people fail becausecompaniesdo not do an adequate job of supporting, mentoring, and onboarding. You would never plant a sapling without watering it and supporting it."

Many leading companies choose to establish a "talent matrix," which identifies employees based on performance and potential. For an example, see Appendix C.

On average, HR officers spend 5 percent of their time in meetings with board members and 12 percent of their time in activities related to their role as board liaison. Source: The Chief HR Officer: Redefining the Role of Global HR Leaders. SHRM Foundation, Society of Human Resource Management, 2012.

IMPERATIVE #7 **Onboarding programs are necessary for all employees, whether they are internal promotions or external hires.**

Mentoring programs can provide critical support and nurture the development of employees. This may require a shift in practices at companies where guidance or coaching is provided only after issues arise and is considered more punitive than an ongoing element of leadership development. To avoid the negative connotation that may be associated with formal guidance and mentoring, companies can provide a mentor when an employee joins the organization. Even for new CEOs, a network of experienced CEOs—plus the board—can provide critical guidance.

A Strategic Human Resources Function

The commission recommends that the HR function serve as the strategic architect for talent and as a liaison to support the board in its talent oversight role. The responsibility for identifying, sourcing, and developing talent is the role of business unit leaders, who are best positioned to continuously monitor performance and progress in their respective areas. The HR team's role is to support management through program development focused on identifying and cultivating talent, providing assistance if the pipeline has stalled, and identifying employee training opportunities.

At companies where HR serves a more traditional role—focusing largely on payroll and benefits—this may necessitate a shift in mindset as well as skills. While the chief human resources officer (CHRO) often supports the compensation and nominating/governance committees in the established areas of pay and succession planning, the board should view this position as a supervisor of the entire employee development program. In this enhanced role, HR aggregates information and analyzes the flow of talent development in business units, which the CHRO then reports to the CEO and the full board.

The relationship between the board and the CHRO—or equivalent leader of the HR function—needs to be strong and based on candor and accountability, as the position is the enabler of talent growth. To ensure that the board is satisfied with the current HR team, the CEO may involve directors in the selection of the CHRO.

IMPERATIVE #8 **The HR function should serve as a strategic architect for talent development—supporting business units and functions in the development of their respective talent pipeline.**

Diversity is an important factor in recruitment, onboarding, leadership development, and mentoring. For additional resources on how the board oversees the consideration of diversity, see the Report of the Blue Ribbon Commission on The Diverse Board: Moving From Interest to Action (2012).

CHAPTER FOUR

Assessment and Reporting

For effective oversight, directors will need to continuously monitor the strength of the entire talent pipeline. This includes receiving regular reports from management that demonstrate the proper functioning of development programs. As the reporting moves up through the organization, most business unit leaders will provide talent updates to whichever committee is tasked with oversight of talent in that business unit.

Quantitative Metrics

It is important that this reporting include both backward- and forward-looking metrics. Many metrics used in risk oversight are lagging indicators—while these can convey important information and help to track progress, directors also need to ask questions that probe the predictive and forward-looking nature of development programs. See below for examples of metrics that boards can use in assessing talent development.

While metrics and data points are necessary in reports from management, directors need to go beyond the numbers to test the "bench strength," or ability of potential successors to step into leadership positions. To assess the company's bench strength, directors can ask for a demonstration of a potential succession three levels down from the top (i.e., the CEO's successors plus the next two levels down). Showing how employees will shift at multiple levels will require management to conduct bench strength analysis at deeper levels within the organization, demonstrating the sustainability of the talent pipeline. It can also provide a warning sign to the board: if one or

> "You can have great numbers, but one move in the company can wipe benches out."

METRICS FOR ASSESSING TALENT DEVELOPMENT

LAGGING	LEADING
Turnover of executive positions, noting if this turnover is due to internal promotion, and if successors are sourced externally or from within the organization	Number of candidates eligible to succeed current C-suite executives, over specific time frames
Turnover at all levels	Number of candidates for key executive positions who are considered "ready now" and "ready in two to three years"
Length of time in current role for current C-suite executives	Percentage of employees with skill sets identified as necessary for long-term strategy
Demographic profile of current employees	Number and percentage of employees defined as "high potential" in development program
Difference in retention rates between high and low performers	How long "high potential" employees stay in their positions before moving to different internal positions
Results of employee engagement surveys (See Soft Indicators section on the next page.)	Demographic profile of candidates

more employees are repeatedly listed as potential successors, the company's development programs may not be developing a sufficient number of employees for future roles. For examples of succession charts, see Appendix D.

As part of the talent component of proposed strategic initiatives, directors should ask for a list of the key employees—and, importantly, the talent bench—that management intends to attach to each project.

Soft Indicators

Weak culture and poor morale at the middle and lower levels of an organization can be leading indicators of a faltering leadership development program. Bad news travels quickly, and a vacuum in leadership or employee uncertainty can quickly leak outside the company to shareholders or analysts. Conducting effective oversight of the tone at lower levels of the organization can prove challenging for the board, however. Although directors should conduct occasional site visits to engage with—and assess the culture of—employees at the operational level, it may be difficult to make multiple visits in a year or see every operational location. This is especially true for companies with foreign operations in which the monitoring of culture is critically important.

Directors should consider using a broad range of tools to get a comprehensive sense of employee engagement and perceptions of the company. In addition to management's reports and site visits, these tools can include employee engagement surveys that assess development and morale beyond the higher levels of the organization. Candid exit interviews—especially of high-potential employees—can provide helpful insights into the company. Additionally, 360-degree evaluations embedded throughout the organization can benchmark the performance of managers in supporting growth and promotion. ▲

CHAPTER FIVE

CEO Succession

CEO succession planning is consistently one of the most challenging areas for boards, and not without reason. Poorly managed succession plans and leadership transitions can pose a serious threat to a company, and thus the ability to create shareholder value. Fumbled transitions (e.g., a CEO deciding not to leave at his or her announced retirement date or a successor quickly departing the company after becoming CEO) not only interrupt business processes, but become headline news.

CEO succession, however, should not be viewed as an "event." Instead, it should be the culmination of a robust, ongoing development process. CEO succession is the result of a number of inputs that begins several layers down in the organization. At the time of an executive transition, the board and CEO identify candidates from the internal pipeline—possibly supplemented by external candidates—to establish a pool of potential successors from which the independent directors select the new CEO.

IMPERATIVE #9 **CEO succession planning should be a continuous and rigorous process; the board should begin identifying potential successors soon after a new CEO is selected.**

If any of these stages in the flow of talent development run off track, the result can be a failed transition. Robust oversight and input from the boardroom significantly raises the probability that the board will have viable options when it selects a new leader for the company. This talent development program, however, should subsequently be complemented with a well-thought out and thorough transition plan for a successful CEO succession.

A notable difference between talent development and CEO succession planning is that in the early stages of talent development, directors have a largely observational role—based on metrics and information from management to ensure that talent is being developed to step into key positions within the organization. Comparatively, the board is directly involved in the selection of a new CEO. Although a search committee may be created and given primary responsibility, the full board is active and accountable.

To help ensure a successful CEO succession process, boards should[11]:

- Begin actively planning succession at least three to four years ahead of an anticipated transition. While the average CEO tenure is currently about five years, the board may consider addressing succession planning as a continuous process, rather than dedicated to an expected transition.
- Work with the CEO to identify a pool of potential successors, assigning them "stretch assignments," allowing the CEO to share some of his or her responsibilities, as well as letting the organization become familiar with the candidates.
- Discuss and come to an agreement with the CEO and HR on the critical attributes of a "successful CEO," which are linked to the company's strategy in both the current environment and under future conditions.
- Take an active role in developing CEO selection criteria and evaluating possible successors, spending the time necessary to make informed judgments about their capabilities, potential, and readiness for promotion.
- Conduct an annual performance review of the CEO to determine whether he or she should

"An essential role of the board is to oversee executive talent management, culminating in a sustainable process to develop and select the next CEO from within the firm. This is the best way to ensure the long-term viability of the enterprise."

continue in that position. (The results of this review should immediately be communicated to the CEO.)

- Openly and honestly express concerns and opinions, whether it is in regard to the CEO's performance or the quality of a potential successor.
- Ensure that the board's own composition reflects a sufficient variety of skills and expertise that qualify the board to identify the leadership needs of the corporation and evaluate prospective candidates.

Tapping External Advisors

In the succession process, external advisors can provide valuable support to the search committee in identifying and evaluating potential candidates—both externally and internally.

As part of succession planning, the board may want conduct an exploratory external search, which allows the board to "peek outside" as part of due diligence before selecting the next leader. This look at outside candidates can also include profiles of CEOs at competitors to benchmark candidates.

IMPERATIVE #10 Third-party perspectives can help the board ensure an objective CEO succession process.

An external advisor can also go beyond searches and may support the board with development and assessment tools for the board to use with potential internal successors—if the external party understands the company's position within its competitive environment. This can include creating development plans and identifying which stretch assignments are needed—which may require changes to the organizational structure. When the transition is near, the external advisor can then help the board identify the next successor from both pools of candidates and create a transition that ensures organizational stability.

Typically, board oversight of succession planning goes beyond organizational charts and dashboards and can be subject to political and emotional issues. Throughout the multi-year process of identifying and tracking potential leadership successors, these issues may become blind spots for some directors. A third-party perspective can sometimes help surface and address these issues and help directors maintain their objectivity.

Every CEO Succession Should Have Multiple Winners

Once a group of potential successors is identified, every director should take the time to personally engage with each of the candidates. At some companies, each candidate is assigned a director as a mentor. While this method allows directors to personally report on candidate progress, it also has the potential to foster biases.

The HR function can help the board stay involved. At each meeting, the board liaison tasked with HR or talent development can provide status updates on each of the candidates.

The actual selection of the new leader is delicate and requires tact. In identifying and allowing the organization to become familiar with the potential successors, the board must be careful to avoid the creation of a "horse race," which can disrupt and demoralize a business as the candidates vie for the position. Although only one successor is selected, in all likelihood the company will still need the talents of the other finalists—who, by definition, are viewed as critical to the company's success. In a worst-case scenario, those not selected may resign (or worse, may seek to undermine the new leader). As such, once the new CEO is selected, that person and the board can be involved in further developing and engaging the other candidates. One commissioner recalled a positive CEO succession experience: "We had three winners, not one winner and two losers. Even if the other two are not selected, if they are excited for their new roles, they are more likely to remain with the company." ▲

Ten Imperatives for Effective Oversight of Talent Development

Success depends on people. The need for improved board oversight of talent development is clear—without the right team in place, the strength of even the best strategy is diminished. Although directors have traditionally focused on the executive team, leading companies are beginning to understand the critical link between strategy, risk, and talent—throughout the organization.

From suggesting boards request reports on the talent bench strength of proposed strategic plans to including talent development in corporate documents, this report details numerous methods boards can adopt to improve their oversight of the talent pipeline in their organization. Acknowledging that every situation is different—depending on such factors as size, industry, and stage of growth—it is the hope of this commission that directors consider, discuss, and incorporate these recommendations as appropriate for their particular company to ensure that it is well-positioned to create long-term sustainable growth and competitive advantage.

The Commission's Ten Imperatives for Effective Oversight of Talent Development

1. To meet future challenges, successful organizations establish multi-year, multi-level internal pipelines of talent.
2. Oversight of the company's talent development efforts should be a full board responsibility, with the actual planning and execution owned by management.
3. The full board should view human capital through the lens of strategy and risk, with committees providing input to the board on talent development in their respective areas of oversight as appropriate.
4. Directors should request that management provide a talent component in every strategic initiative presented to the board.
5. To ensure that talent receives the necessary time and focus, boards should consider drafting talent oversight and succession planning into official corporate documents.
6. The company's hiring philosophy, employee retention and incentive programs, and corporate culture should all align to support a robust talent pipeline and long-term talent strategy.
7. Onboarding programs are necessary for all employees, whether they are internal promotions or external hires.
8. The HR function should serve as a strategic architect for talent development—supporting business units and functions in the development of their respective talent pipelines.
9. CEO succession planning should be a continuous and rigorous process; the board should begin identifying potential successors soon after a new CEO is selected.
10. Third-party perspectives can help the board ensure an objective CEO succession process. ▲

Sample Risk Dashboard

Key Risk Indicator Description	Q3	Q4	Q1	Comments
Through our succession planning process, ensure that at least 50% of our key staff has identified "emergency" or "ready now" replacements.	●	●	◐	
Turnover of senior and executive management (SVP/EVP) should be less than 10% of total company terminations.	●	●	●	
Senior and executive (SVP/EVP) turnover should be less than 10%.	◐	●	●	
Annual employee turnover should be less than 15%.	○	○	○	
Median SVP/EVP recruitment time of less than 105 days.	○	○	○	
At least 70% of key staff identified with skills necessary for long-term strategy.	○	○	○	
Senior positions should be filled with more than 40% of internal promotions.	●	●	●	
Employee engagement surveys measure the drivers of organizational performance (working conditions, managers, pay, etc.) against industry peers.	◐	◐	○	

●	Indicates high risk/change in risk profile
◐	Indicates moderate risk/change in risk profile
○	Indicates low risk/change in risk profile

APPENDIX B

Corporate Governance Documents

American Express Co.

Form 10-K

"Our success is dependent, in part, upon our executive officers and other key personnel, and the loss of key personnel could materially adversely affect our business."[12]

"Our success depends, in part, on our executive officers and other key personnel. Our senior management team has significant industry experience and would be difficult to replace. Our senior management team is relatively small and we believe we are in a critical period of competition in the financial services and payments industry. The market for qualified individuals is highly competitive, and we may not be able to attract and retain qualified personnel or candidates to replace or succeed members of our senior management team or other key personnel."[13]

Proxy Statement

"One of our board's primary responsibilities is to ensure that we have the appropriate management talent to successfully pursue our strategies. Oversight of the management succession process is the responsibility of the Nominating and Governance Committee. Our board believes that the directors and the CEO should collaborate on succession planning and that the entire board should be involved in the critical aspects of the CEO succession planning process, including establishing selection criteria that reflect our business strategies, identifying and evaluating potential internal candidates, and making key management succession decisions.

"Management succession is regularly discussed by the directors in board meetings and in executive sessions of the board. Our board annually conducts a detailed review of the company's talent strategies, leadership pipeline, and succession plans for key executive positions. Directors become familiar with potential successors for key management positions through various means, including the comprehensive annual talent review, informal meetings, board dinners, and presentations to the board."[14]

The Nominating and Governance Committee responsibilities include "oversee[ing] the company's management succession process."[15]

"Non-management directors use these executive sessions to discuss matters of concern as well as any matter they deem appropriate, including evaluation of senior management, CEO and management succession."[16]

Corporate Governance Principles

"Assuring that the Company has the appropriate management talent to successfully pursue the Company's strategies is one of the Board's primary responsibilities. To fulfill this responsibility the Nominating and Governance Committee shall assure that the Company has in place appropriate planning to address emergency Chief Executive Officer succession, Chief Executive Officer succession in the ordinary course of business and succession for key members of senior management. The Company's Chief Executive Officer succession planning shall include criteria that reflect the Company's business strategies, identification and development of potential internal candidates and formal assessment processes. Directors are expected to become sufficiently familiar with the Company's executive officers as to be able to offer personal feedback on the performance of such officers, including by participating in an annual Executive Talent Review of the experience, capabilities and performance of the Company's senior management."[17]

The Coca-Cola Co.

Proxy Statement

A statement by Herbert A. Allen, Chairman of the management Development Committee: "Succession planning and the development of people are key to achieving our 2020 Vision and ensuring the long-term sustainable growth of our business. Under Don Keough's leadership, this committee has overseen the development of a very deep and talented management bench. I look forward to continuing this important work."[18]

“The Management Development Committee helps the Board fulfill its responsibilities relating to oversight of talent development for senior positions and succession planning.”[19]

Corporate Governance Guidelines

“The Board will determine policies and principles for selection of the Chief Executive Officer and policies regarding succession in the event of an emergency or the retirement of the Chief Executive Officer. The Board, with input from the Management Development Committee, will oversee senior management development and the planning for succession to senior positions.”[20]

Google Inc.

Form 10-K

“If we were to lose the services of Larry, Sergey, Eric, or other key personnel, we may not be able to execute our business strategy.

“Our future success depends in a large part upon the continued service of key members of our senior management team. In particular, Larry Page and Sergey Brin are critical to the overall management of Google and the development of our technology. Along with our Executive Chairman Eric E. Schmidt, they also play a key role in maintaining our culture and setting our strategic direction. All of our executive officers and key employees are at-will employees, and we do not maintain any key-person life insurance policies. The loss of key personnel could seriously harm our business.”[21]

Proxy Statement

A responsibility of the Leadership Development and Compensation Committee is“[r]eviewing plans for the development, retention, and succession of our executive officers.”[23]

“One of our board of directors’ principal duties is to review management succession planning. The Leadership Development and Compensation Committee reviews at least annually and recommends to the full board of directors plans for the development, retention, and replacement of executive officers, including the Chief Executive Officer, of Google. Additionally, the Leadership Development and Compensation Committee and the Nominating and Corporate Governance Committee of our board directors are jointly responsible for overseeing the risks and exposures associated with management succession planning.

“Our board of directors believes that the directors and the Chief Executive Officer should collaborate on succession planning and that the entire board should be involved in the critical aspects of the management succession planning process, including establishing selection criteria that reflect our business strategies, identifying and developing internal candidates to ensure the continuity of our culture, and making key management succession decisions.

“Management succession is regularly discussed by the directors in board meetings and in executive sessions of the board of directors. Directors become familiar with potential successors for key management positions through various means, including regular organization and talent reviews, presentations to the board, and informal meetings.”[24]

Corporate Governance Guidelines

From the Principal Duties of the Board of Directors Section: “To Review Management Succession Planning. The Leadership Development and Compensation Committee will review at least annually and recommend to the Board plans for the development, retention and replacement of executive officers of Google.”[25]

APPENDIX C

Talent Matrix

TALENT MATRIX		
Functional Expert Consistently produces very good results and high-performance ratings. Knows current job extremely well. May not effectively adapt to change.	**Adaptable Pro** Consistently produces exceptional results and high-performance ratings. Knows the job well and continuously enhances skills. Adapts to change as needed.	**High Potential** Outstanding, clear superior performance and potential. Has the ability to take on stretch assignments. Desires continual growth opportunities.
Consistent Performer Meets expectations. Knows current job well. May not effectively adapt to change.	**Key Performer** Consistently meets expectations. Knows current job well and enhances skills as appropriate. Can adapt to change as needed.	**Future Star** Consistently meets/exceeds expectations. Knows the job well and seeks development. Has the ability to consistently take on new and different challenges.
Poor Performer Not delivering on results as expected. Does not adapt to change well and may be blocked in ability to grow and learn.	**Inconsistent Performer** Delivers results inconsistently. Knows the job. May be a passive learner. May adapt to new situations if necessary.	**Unrealized Potential** Delivers results erratically. Has demonstrated potential, but is not living up to it. May not fit into the culture of the organization.

PERFORMANCE OVER TIME

GROWTH POTENTIAL

APPENDIX D

Sample Readiness and Succession Charts

Readiness/Bench Chart

For specific positions, the following two charts show the relative readiness for others to step into these roles. The first chart[26] shows the bench strength for direct reports to one C-suite officer while the second shows planning for the entire C-suite. The purpose is to guide discussion on key talent, plan rotations or developmental moves, or develop other specific action steps.

Chief Financial Officer

	[name] SVP, Accounting	[name] VP, FP & A	[name] VP, Treasury	[name] VP, Investor Relations	[name] VP, Tax
Ready Now	Fran Smith Brian Bowman	External Hire	Barbara Boulder Tom Holder	Re-Organize	Evan Jones Glenn Martinez
Ready 1-3 Years	Ed North	Kwame Gold Tim Anderson	Tim Bridges		Fran Smith
Ready 3-5 Years	Rich O'Hara	Rebecca Chamberlain Mike Devlin	David Braun Dorothy Hertzel		

Succession Planning

CEO	CFO	COO	EVP: Strategy
Name (2-3 years) Name (3-5 years)	Name (3 years)	Name (1-2 years) Name (3-5 years)	Name (ready now)

EVP: HR	General Counsel	CIO	CMO
Name (2-3 years) Name (2-3 years)	Name (ready now) Name (3-5 years)	Name (2-3 years)	Name (1-2 years) Name (2-3 years)

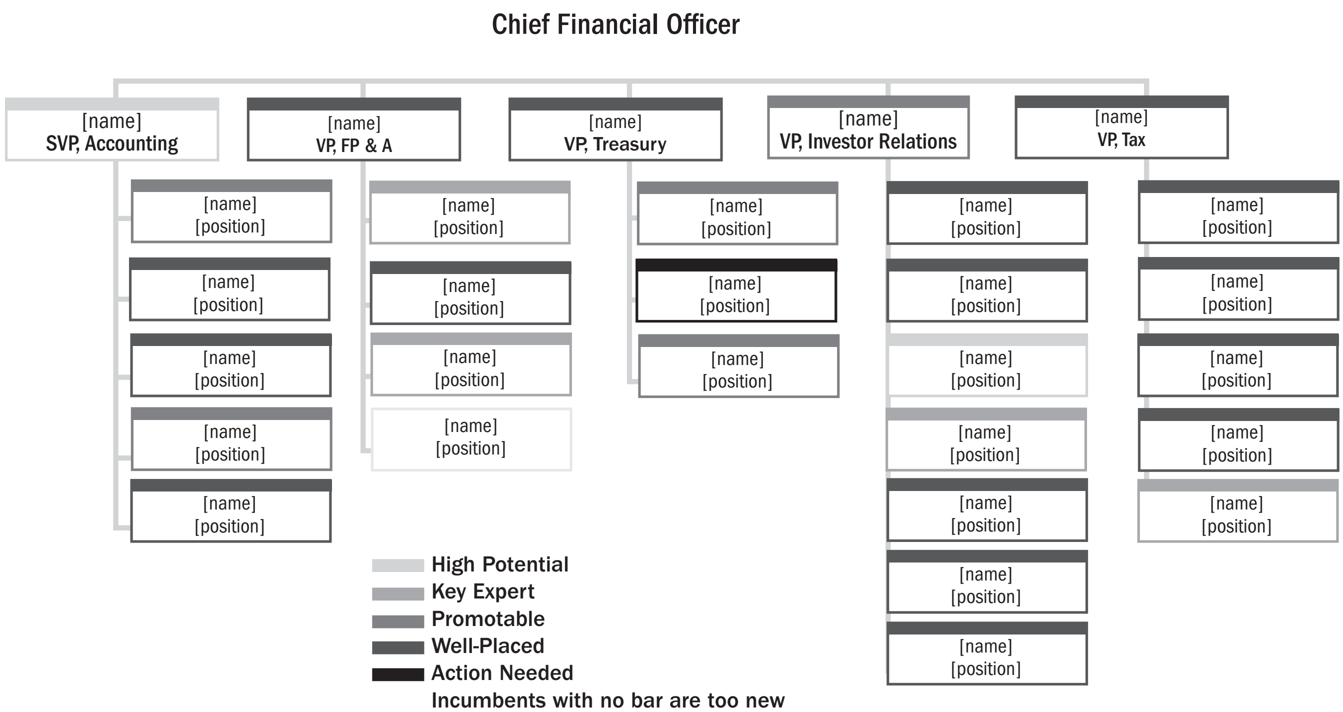
Region President Bench

Ready (1-2 years): Name, State President Name, SVP Name, SVPGM

Ready (3-5 years): Name, SVP Name, SVPGM Name, SVPGM

Current Incumbent Organization Chart[27]

The chart goes two levels into the organization. It shows—by gray scale coding—the strength of the current leaders. At a glance, the board has a visual display of the strength of the current leadership.

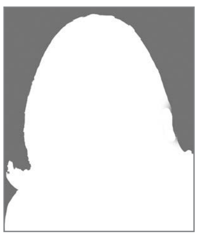


APPENDIX E

Executive Profile Template

Profiles of the executives to be reviewed can be included with board materials. These are available for reference during the discussion. A sample of the format is shown below.

SUCCESSION TEMPLATE



Chairman, CEO & President

CONTACT INFORMATION

Full Name:
Title:
E-mail:
Country:

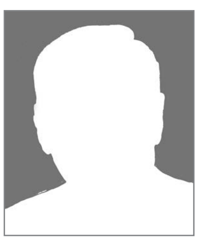
EXPERIENCE SNAPSHOT

Time in Current Position:
Time at Company:
Earliest Retirement Date: Likely Retirement Date:

FORMAL EDUCATION

School	Major	Degree or Equivalent

CEO Candidate: Joe Smith – Capable Now – Short Term (< 12 months)



CONTACT INFORMATION

Full Name:
Title:
E-mail:
Country:

EXPERIENCE SNAPSHOT

Time in Current Position:
Time at Company:

Work experience with Company (Last 4 roles)

Start Date	End Date	Job Title	Segment/Region/Unit	Function

EXPERIENCE SNAPSHOT

Start Date	End Date	Company Name	Job Title

FORMAL EDUCATION

School	Major	Degree or Equivalent	Other Degree/Major

Strengths:

Development Areas/Actions:

Function:

Endnotes

[1] Pankaj Ghemawat, "Developing Global Leaders," *McKinsey Quarterly* (June 2012).
[2] James S. Ang & Gregory Leo Nagel, *Inside and Outside Hired CEOs: A Performance Surprise* (Nov. 6, 2009), 36.
[3] Ellen S. Hexter & Mary B. Young, *Managing Human Capital Risk: A Call for Partnership Between Risk Management and Human Resources* (The Conference Board, 2011).
[4] Fred G. Steingraber et al., *"Home-Grown" CEO* (A.T. Kearney Inc., 2011).
[5] See National Association of Corporate Directors (NACD), *2013–2014 NACD Public Company Governance Survey* (Washington DC: NACD, 2013), conducted between April and June 2013, n= 1,019 public company respondents.
[6] Mercer, *Monetising Leadership Quality: The Analysts' Lens on Leadership Equity* (Marsh & McLennan Companies, 2013) [hereinafter Mercer, *Monetising Leadership Quality*].
[7] Mercer, *Mercer Talent Barometer Survey* (Marsh & McLennan Companies, 2012). Survey includes responses from HR and talent management executives of 1,268 organizations—varying in size from fewer than 1,000 employees to more than 10,000 employees—representing 65 countries around the globe.
[8] Peter Drucker, *The Practice of Management*, 1st ed. (New York: HarperCollins Publishers, 1954).
[9] Mercer, *Monetising Leadership Quality*, *supra* note 6.
[10] Mercer, *Talent Rising: High-Impact Accelerators* (Marsh & McLennan Companies, 2013). Twenty-seven percent of organizations that build critical talent view their workforce plans as "very effective," as opposed to 15 percent of organizations that buy their critical talent. Just 11 percent of build organizations view their plans as "not at all effective," compared to 23 percent of those that buy.
[11] Portions of this guidance are based on previous NACD materials, including National Association of Corporate Directors (NACD), *CEO Succession* (Washington DC: NACD, 1998) (a report of the NACD Blue Ribbon Commission) and National Association of Corporate Directors (NACD), *The Role of the Board in CEO Succession* (Washington DC: NACD, 2006) (a report of the NACD Blue Ribbon Commission).
[12] American Express Co., (Form 10-K) 79 (Feb. 22, 2013).
[13] *Id.*
[14] American Express Co., Proxy Statement for 2013 Annual Meeting of Shareholders (Schedule 14A) 9 (Mar. 8, 2013).
[15] *Id.* at 11.
[16] *Id.* at 69.
[17] *Corporate Governance Principles* (American Express Co., 2012), 8-9.
[18] The Coca-Cola Company, Notice of 2013 Annual Meeting of Shareowners and Proxy Statement (Schedule 14A) 36 (Mar. 11, 2013).
[19] *Id.*
[20] Coca-Cola Co., *Corporate Governance Guidelines*, http://www.coca-colacompany.com/investors/corporate-governance-guidelines#TCCC (last visited June 14, 2013).
[21] Google Inc., (Form 10-K) 21 (Jan. 29, 2013).
[22] *Id.*
[23] Google Inc., Notice of 2013 Annual Meeting of Stockholders and Proxy Statement (Schedule 14A) 16 (Apr. 24, 2013).
[24] *Id.* at 19-20.
[25] Google Inc., *Corporate Governance Guidelines*, http://investor.google.com/corporate/guidelines.html (last updated Apr. 11, 2012).
[26] Chart courtesy of CNO Financial Group.
[27] *Id.*