Success at the Top

CEO Evaluation and Succession

DIRECTOR'S HANDBOOK SERIES
2014

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Special Thanks

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Table of Contents

High Stakes, High Priority

The stakes of CEO evaluation and succession are high. Executive leadership is integral to the prosperity of any corporation. The right CEO and team can inspire a lackluster organization to greater achievements, while mediocre leadership is lucky to maintain the status quo. It is no wonder that according to the National Association of Corporate Directors' (NACD's) *2014–2015 Public Company Governance Survey*,[1] boards ranked both CEO succession and executive talent development among their top-five priorities.

There is real value in proactively addressing CEO performance. Discussions about leadership style and vision can be sensitive and difficult without a formal evaluation process. As such, dialogue about any problems between the board and CEO may fail to take place. A formal CEO evaluation process provides a natural forum for a direct exchange of opinions on important topics relevant to the leadership and management of the company.

Practical Guidance

Because the core principles of CEO evaluation and succession are in many ways interrelated, we have constructed this handbook as a series of modules. The first two modules focus on process: Module One contains an overview of the performance evaluation and Module Two discusses CEO succession planning. Module Three looks at the major players—specifically the roles of the board and management in evaluation and succession. The final modules address the action steps: selection and compensation of the next CEO in Module Four, and the transition and assimilation of the new CEO in Module Five.

While reading this handbook, board members may wish to consider the following questions:

- What is a good process for managing CEO evaluation?
- What is an effective process for managing CEO succession?
- What are the key roles in CEO evaluation and succession and who fulfills them?
- How can the board find the "right" CEO?
- What are some considerations for negotiating compensation?
- How can directors ensure a smooth transition and assimilation?

Much of the text in this handbook draws from the enduring recommendations of NACD Blue Ribbon Commissions, from the earliest commission on CEO succession, chaired by Jeffrey Sonnenfeld, to the most recent commission exploring talent development, co-chaired by Greg Lau and Mary Pat McCarthy. NACD's staff has gathered all of this information into a single source of practical guidance. We trust that you will find it useful.

Kenneth Daly, President and CEO
August 2014

MODULE ONE

Evaluation: How to Assess the Performance of an Incumbent CEO

Leadership of the corporation is represented both substantively and symbolically by the CEO. An outstanding CEO can galvanize a corporation with inspirational leadership and sweeping vision. Such CEOs are experts at being both diplomatic and tough, and are adept at recognizing the proper balance between these traits. They have insight, courage, persistence, and creativity. Furthermore, they make extraordinary contributions to the corporation's constituents, including consumers, shareholders, employees, and the community.

Some boards may believe that through the design of incentive compensation plans, they have adequately evaluated the CEO and senior executives. Others may assume that extensive, ongoing communication from the board regarding management's performance makes formal reviews unnecessary. Evaluation should transcend compensation and communication. Without an established and articulated process, the board cannot formally assess executive success or failure in a thorough manner.

The CEO Evaluation Process

In the CEO evaluation process, discrepancy can occur in the definition of performance.[2] The company's financial performance, such as operating profit or total shareholder return (TSR), is often used to evaluate the CEO's performance.

To be comprehensive, however, CEO performance evaluations should consider factors that not only include but go beyond corporate performance—and the definition of corporate performance should include more than profitability and/or shareholder returns for any one period.

While corporate performance measures may work for other senior executives, CEO performance evaluation requires greater rigor than other executive performance assessments. All executives should be held to high standards, but the CEO must meet the highest marks of all, as he or she is constantly in the spotlight, has greater responsibility, and is accountable to a larger breadth of constituencies.

Company culture will be a key factor in determining the most appropriate approach to conducting CEO evaluations. Consideration should also be given to the company's specific situation: Is it a large and mature public company focused on external reputation with multiple stakeholders? Conversely, is it a new, entrepreneurial company with owners who also work for the company? Answering these questions will help to determine the level of formality needed in the evaluation. Some companies will do well with the discipline and clarity of a formal written process, while others may prefer the flexibility of a less formal oral procedure. Referenced in governance guidelines, formal practices can demonstrate to shareholders that a transparent process is in place to evaluate and compensate CEO performance.

Six Imperatives for Setting Corporate Performance Metrics[3]

1. Understand and agree on the company's key performance metrics. These key metrics, set for both the enterprise as a whole and for major business units, should be used to track progress against the company's strategy.

2. Establish company performance metrics to cascade throughout the entire enterprise. The board should ensure that management has used the metrics to establish more robust and detailed metrics at lower levels.

3. Track company performance against metrics on an ongoing basis. Metrics need to be set annually and monitored over time.

4. Establish consistent and appropriate executive performance metrics. These measures should be used not only for compensating top officers, but also for managers throughout the organization.

5. Follow through on executive performance metrics. Based upon an assessment of performance and the context for performance, including consideration of risk, determine compensation payouts for top officers and approve payout levels for management generally.

6. Communicate with shareholders regarding how the company has paid for performance. Use clear language to convey the reasons and results of compensation practices.

Other companies may blend the two approaches. For example, formal evaluation can be preceded by a number of informal meetings. In any event, CEO evaluation should be a confidential process tailored to the company.

The following is one possible model:

- The board appoints a designated independent director or directors to serve as leaders of the CEO evaluation process. In many cases, the designated director will be the non-executive chairman, or the chairman, or a member of the governance committee, the compensation committee, or a similar committee of independent directors. The person (or persons) responsible for leading CEO evaluations plays a key role in delivering the value of the process. (See sidebar on page 8, "Benefits of CEO Evaluation.")
- The CEO evaluates how he or she has performed in the current year—and perhaps in past years as well—against stated goals, including goals related to the annual plan and any longer term strategic plan in effect for each of the years analyzed. This evaluation in most cases takes place annually—with a mid-year assessment to check progress—and covers each performance objective and the major duties and responsibilities outlined in the CEO's position description.
- The outside directors meet independently to discuss the CEO's self-assessment.
- The outside directors then conduct their own evaluations, conveying them to the designated director for consolidation. Alternatively, a committee of directors may prepare a single, joint evaluation. This committee may take into account the views of senior managers through a 360-degree evaluation process.
- The outside directors review and approve the consolidated evaluation. Excluding the CEO from the assessment discussions provides an open forum for board members to raise issues freely. The documented outcome of the evaluation can then be discussed with the CEO.
- The designated director or directors meet privately with the CEO to discuss the consolidated evaluation.
- The CEO then meets with the outside directors to react to the evaluation and discuss appropriate next steps. Some companies use a third-party facilitator to initiate the CEO evaluation process. Any facilitator chosen will need to have a solid understanding of relevant corporate governance practices, including the roles and responsibilities of the CEO and the board. It may be desirable for the individual to be an experienced corporate director or a present or former CEO.

When the CEO is performing well, the board must still work with him or her to mentor, develop, retain, and motivate. Among the tools to achieve this are continuous open and positive feedback, developmental programs aligned with the toughest challenges, and pay programs linked to "stretch" results.

If the board is unable to bring the CEO's performance up to an acceptable level, it must move promptly to replace him or her, ideally with a candidate that has already been identified as an acceptable choice in case of the CEO's departure.

SITUATION-SPECIFIC TRAITS TO CONSIDER IN CEO EVALUATION

CEOs should not be evaluated in a vacuum. It is critical to consider the company at its particular time in development.[4]

The ideal CEO…

IN A **RAPID GROWTH ENVIRONMENT**

- is pragmatic;
- is able to look beyond traditions and habits;
- is able to identify the critical organizational functions and processes that may need to be created or further developed;
- will maintain a strong sense of purpose and focus;
- is highly motivated and helps motivate others;
- will continually raise the bar of performance expectations;
- is able to articulate a clear vision of the future;
- is able to delegate authority, and is comfortable trusting others to get the job done; and
- relates well at many levels within the organization, and relates well to external constituents (e.g., customers, analysts, etc.).

IN A **TURNAROUND SCENARIO**

- has a near-term focus with long-term awareness;
- may be somewhat impatient, but is sound in his or her decision making;
- is detail oriented, a strong problem-solver, and able to maintain a survival focus;
- is decisive, able to think on multiple levels, and recognizes that at any given time there may be several "number one" priorities;
- can visualize a new business strategy;
- has a focus on core issues, high energy and stamina, and a drive to achieve;
- has the ability to stand his or her ground in the face of resistance and criticism; and
- is a clear and concise communicator and makes a strong personal impact.

IN A **MERGER INTEGRATION**

- is savvy in merger and acquisition situations;
- acts quickly but is thoughtful and can assess all relevant information before making decisions;
- is able to focus on the long term (i.e., beyond the initial transaction or deal);
- is able to visualize a picture of the future organizational state;
- values people as resources—a trait critical to creating and fulfilling a vision;
- addresses conflict head-on;
- is assertive in articulating expectations;
- is sensitive to organizational styles and individual differences; and
- is able to understand and effectively manage relationships within the financial community.

IN AN **INDUSTRY UNDERGOING STRUCTURAL SHIFT**

- demonstrates a clear sense of what the future will hold, and where the company will go;
- is able to identify barriers to change;
- has excellent industry knowledge;
- is able to think innovatively;
- values people as resources;
- is comfortable with ambiguity;
- maintains a passion for and easily embraces change;
- clearly articulates expectations;
- is assertive and firm with those who are resistant to change;
- can build strong relationships with external constituents (e.g., customers, analysts, etc.); and
- relates well at many levels within the organization.

What to Evaluate in a CEO

The following is a sample list of what might be evaluated in a CEO or any successor candidate.

- **Integrity.** How the CEO makes decisions and how he or she responds to difficult situations.
- **Vision.** How well the CEO can envision new paths for the company.
- **Leadership abilities.** How staff responds to the CEO's effectiveness as a leader and team builder, including diversity of the work force and leadership team.[5]
- **Performance.** The ability to meet both financial and non-financial goals.
- **Succession planning.** The match between CEO and senior management competencies and company needs, both current and future.
- **Fitness.** Physical and psychological strength and stamina.
- **Relations.** The quality of relationships with board members, shareholders, and other stakeholders. ▲

Benefits of CEO Evaluation

When properly conducted, CEO performance evaluation can

- facilitate board-CEO communication regarding company and CEO performance expectations, both in the short and long run;
- improve communication between the board and the CEO regarding the evaluation of actual performance;
- help the CEO identify personal strengths and ways to capitalize on them;
- help the CEO identify personal weaknesses and ways to correct them;
- provide early warning signals of potential problems to the CEO and the board;
- provide clear guidelines for CEO compensation decisions, including not only formulas for incentive compensation, but also guidance as to when these formulas should be overridden;
- help to foster a sense of teamwork between the board and the CEO;
- increase the likelihood that the board will support the CEO in times of crisis; and
- provide a clear signal to shareholders and regulators that the board is monitoring and evaluating the actions of the CEO and senior management.

MODULE TWO

Succession: Developing a CEO Succession Process

The board is not only accountable for the selection and evaluation of the CEO, but also for recognizing when new leadership is needed, and for spearheading the succession process. But selecting the next corporate leaders cannot be left to chance, corporate politics, or personal friendships. Instead, the selection should be the result of a thorough and fair process orchestrated by the board in partnership with the incumbent CEO. Without a formal process, boards may ignore this responsibility and allow the current CEO to determine how and when he or she will be replaced.

How, then, can the board fulfill this responsibility effectively? First, it is important to recognize that CEO evaluation and CEO succession planning are interdependent. To evaluate an incumbent CEO effectively is to pave the way for his or her successor. Additionally, every potential successor should undergo evaluation. As such, evaluation forms the blueprint for succession planning, and the criteria used in CEO evaluation can also be used for CEO succession.

Effective succession planning requires a process developed by the board that is refined over time. To meet all eventualities, the board should ensure that the organization is sufficiently talent-laden to allow for seamless succession, and, based on established time horizons, should regularly reflect on potential replacements should the incumbent CEO suddenly leave. An annual evaluation of the incumbent CEO and senior management team will determine the development status of identified potential successors within the organization through multiple lenses of immediate, three-year, five-year, and longer intervals. In some cases, such an evaluation may be part of a formal contract with a CEO. (See Appendix D for a sample CEO succession process.)

Every CEO evaluation should include CEO succession components, and every CEO succession plan should include evaluation components.

Developing a Succession Plan

The board of directors plays a key role in determining what kind of leadership a company needs—and will need—and ensuring that the company is staffed with current and future leaders. To ensure success at the top, the board should regularly assess all strategic opportunities and determine how they align with the company's current leadership capabilities. This ongoing strategic assessment should not be undertaken lightly. The board must create a process whereby this assessment can take place on a regular basis and lead to changes in senior management when necessary.

The *Report of the NACD Blue Ribbon Commission on Talent Development: A Boardroom Imperative* notes that in addition to its regular evaluation of the CEO and related development and retention efforts, the board must periodically consider the depth of leadership talent within the corporation's management team to ensure that the right complement of skills and personalities are being cultivated with future needs in mind. Additionally, to ensure maximum corporate performance, directors should take steps to energize, motivate, and retain high-performing talent. These activities should be done in collaboration with the CEO.

Failed succession planning can be extremely painful to a company. In some instances, boards can be caught unprepared when a CEO passes away or leaves abruptly for another opportunity; in others, they may allow an exiting CEO to impede a successor's integration into the company. Furthermore, a board's reluctance to manage competition among internal candidates can result in the loss of critical and talented managers. These problems persist in many otherwise successful firms, yet they can be avoided through planning.

Development and recruitment of tomorrow's top management is an essential part of any company's long-term strategy. Every company should have at least two plans established: a long-term succession plan that assumes a normal tenure for the CEO; and a contingency plan for unexpected crises, such as losing the CEO to another job, sudden illness, injury, or even death.

In fact, a change of a CEO can occur from a range of causes, including a planned and voluntary departure after a period of distinguished service. A CEO's departure can also be the result of other issues, including:

- Poor performance.
- Strategic disagreement between the CEO and the board.
- Personality clashes between the CEO and the board.
- Change of control (i.e., when two firms are merging and only one CEO is needed).
- "Idée fixe"—a single issue that the CEO refuses to compromise over, even if it results in his or her exit.
- Personal problems or illegal or improper behavior of the CEO that may damage the company's reputation.

Core Succession Planning Principles

Each company, each board, and each succession has its own particular circumstances to consider. As such, this handbook identifies five core principles[6] for boards and top management to use in selecting a process that best suits their situation.

1. **The goal of CEO succession planning is finding the right leader at the right time.** Different skills and strengths are required at different times in the company's life. Moreover, CEOs themselves change over time and they may not feel the same passion and commitment after some time in the position. For these reasons, directors should continually ensure that the current leadership is meeting the needs of the company and its constituents. Well-timed transition to new leadership enhances stakeholder confidence and long-term company value.
2. **CEO succession is a board-driven, collaborative process.** Although the current CEO has an important role to play, the board drives the process and should collaborate with the CEO in deciding the timing and the necessary qualifications for making a final decision.
3. **CEO succession is a continuous process.** Planning for the next leader should start as soon as a new CEO is selected. The board should be constantly aware of how long the current CEO can or should continue in the position, what steps are needed to find a successor, and who will step in if the CEO leaves suddenly or is unable to continue. The board is also responsible for fostering the current CEO's development as a leader and addressing his or her concerns so as not to lose an exemplary CEO to another organization.
4. **The board should ensure that the CEO builds a talent-rich organization by attracting and developing the right people.** Although boards may look outside the company for successors, the company itself is a primary resource for candidates. Promoting from within can also minimize the disruption of a transition period to a new CEO.
5. **Succession planning should be driven by corporate strategy.** There is a strong tie between leadership ability and corporate performance. The board should ensure that the CEO—or, during times of transition, any candidate for the CEO position—has both a clear understanding of the corporation's strategic vision and concrete ideas on how to implement that vision. Moreover, the board should recognize that leadership competencies are not all the same and industry dynamics are constantly changing. As such, boards should frequently ensure alignment between the strategic skills senior managers possess and the future strategic challenges they face.

Regardless of the reason for the change in leadership, the identification and selection of successors must start long before the departure event. The board plays an important role here; inaction can cause problems.

CEO succession is a complex and challenging process that requires months of strategic planning and years of forethought to ensure a smooth and successful transition to new leadership. The following elements are integral to this process: an understanding of the company's current, as well as future business strategy and vision; the climate of the industry and its marketplace; and the dynamics of management and employee relations. It is the job of the board of directors to assimilate this information, create a profile of an ideal candidate, and select a successor who can be expected to fit the needs of the company over time.

Key Action Points for Managing CEO Succession

Just as the development of a CEO succession process should be tailored to each company's situation, managing the actual process will vary. These broad action steps for succession planning, however, can apply to most.

- Determine what behaviors and competencies are desired in a CEO to lead the business today and into the future.
- Revise the CEO job description to reflect expectations and compare the CEO's evaluation against that job description.
- Benchmark the CEO's performance against CEOs at peer companies as feasible.
- Identify a diverse talent pool.
- Make sure the talent pool has near-term and long-term successors at all times. (A seemingly ideal situation can quickly become tenuous, so the board should be prepared at all times.)
- Become familiar with the current top management team, as well as potential outside successors.
- Announce the choice of a successor to occur when it is most constructive for the company.

Keeping the Right Time Horizon(s)

The difference between CEO selection and CEO succession points to the importance of starting the process as early as possible. CEO selection is a specific event and driven by a timeline. CEO succession, on the other hand, is an ongong process utilizing development planning linked to business strategy. The competencies sought in future leaders should be continually reviewed and altered to fit the unique industry and technical requirements arising in the marketplace.

As mentioned earlier, CEO succession planning requires constant oversight over a long period of time. Ideally, the process will result in a talent pool that identifies both near-

Warning Signals That the Board Has Not Fulfilled Its Responsibilities[7]

If a company lacks an effective succession planning process, there are warning signs directors should heed. While each red flag can occur for legitimate reasons, any, and especially more than one, should suggest to board members that their succession procedure might require revision.

- Lack of internal candidates for the CEO position.
- Continuing poor or mediocre performance by the company.
- Departure of promising top management candidates.
- Crisis created by personal or health issues that should have been known and addressed by the board.
- Retirement of CEO delayed due to the lack of a successor.
- Time-based succession planning scheduled around planned retirements instead of performance-based succession planning.
- Designation of the company by shareholder activists, negative reports by analysts or financial or trade press.
- Excessive focus on compensation and dramatic changes in performance measures.
- CEO attempts to control the board by restricting access to top management, or discouraging executive session meetings of the outside directors.

The board should always have a view of the future and the leadership that will be needed.

term and long-term CEO candidates. Proper succession planning considers unanticipated events that create short-term crises, such as the sudden departure of the CEO, as well as longer term changes in the business. In the case of short-term succession, the board may need to consider one of its own members to step in on an interim basis to run the organization.

For many, the potential for change and crisis necessitates that the succession process start as soon as the new CEO is selected. While it may seem peculiar to the new CEO, this is a critical step in ensuring consistent leadership.

This is not to suggest that the board should rank CEO candidates, name one and then immediately name his or her successor. This would not be fair to the new CEO, who will need sufficient time to fully develop in the role.

While allowing the new CEO to develop, the board should always have an "emergency" candidate who is prepared to act as interim CEO in the event of an unforeseen situation (e.g., illness or death of incumbent).

Linking Strategy to Succession

Typically, the board, the CEO, the senior management team, and top human resource executives will be involved in linking strategy and succession plans. This breadth of involvement ensures that plans are both developed and executed, and that key individuals are aware of developmental needs and opportunities that exist throughout the organization. Using processes that reinforce the link between business strategy and succession planning minimizes the chance of these participants emphasizing the mechanics of the succession process over the necessary resource planning and development.

This analysis requires that a company have measurable goals that track performance against competitors, shareholder value benchmarks, and the strategic plan. Some of these goals may be the same goals in the CEO's short- and long-term incentives, such as TSR relative to peers or to a market index, or they may be goals for action, such as undertaking specific leadership initiatives in new business areas. The following are several factors that should be analyzed in the CEO succession planning process:

- **The company's current performance.** Is the firm performing at acceptable levels? Why or why not? Is this performance likely to change?
- **The company's strategic direction (including the CEO's vision).** Is the plan in place? Is the company moving in the targeted direction? Is the company achieving key milestones?
- **The CEO's performance.** Is the CEO performing adequately or not? What characteristics and competencies are contributing to performance expectations? (See Module One of this handbook for factors to evaluate in a CEO.)
- **Senior management team performance.** Is the team performing adequately or not? Does the team contain the right individuals to fulfill the current and future goals of the company?
- **The board's performance.** Does the board contain the right individuals to provide effective oversight for the current and future needs of the company?

Internal Resourcing and Development

When reviewing internal candidates, directors should not let titles, experience, or level of compensation cloud judgment. Instead, it should assess work-level competencies, industry and technical competencies, and strategic competencies of all the individuals in the talent pool. A resume may suggest work-level competencies, but will tell little about the other critical dimensions of executive talent.

One effective way for boards to assess the full range of candidates' competencies is to divide into small teams of two to three people—each of which spends one day interviewing and assessing candidates. The interview questions are developed by the incumbent CEO in conjunction with the board committee charged with the responsibility for CEO succession, along with any senior personnel in the company who may be involved in management development. Responses to these questions should provide the information needed to determine if a candidate has future CEO potential.

Directors should also make an effort to know the available resources within the management team, as well as establish a frank dialogue with those working directly below the CEO. Conducted in conjunction with the incumbent CEO, these conversations can assist in establishing the necessary qualities required for the CEO position. This also allows the board to monitor executive development and capability.

Internal vs. External Talent

CEO succession inevitably raises the question of choosing internal vs. external candidates. The better a company's talent development program is, the more likely there will be internal candidates for consideration. The best-managed companies anticipate future leadership qualities and groom them from within, reducing the need to look outside for a successor.

There are a number of advantages to hiring an internal candidate. They understand the past and present of a company's business, culture, strategy, and relationships, enabling a faster start-up after the former CEO's departure. These candidates have also gone through internal development programs, which essentially provide the board with protracted "interview" periods to watch candidates grow and develop within the organization. Championing internal candidates may be easiest when the incumbent CEO has had a thriving tenure and the board believes that an internal candidate is likely to perpetuate the current success.

This preference for inside candidates, however, should be tempered with a willingness to look beyond the company in a search for a successor. The rate and magnitude of business changes today require that even successful organizations compare their internal leadership candidates against candidates from outside companies. Potential candidates may be found not only in companies in the same industry, but also other industries with parallel challenges. Often new technology and market changes create needs for CEO skills that are new to the firm and most effectively located in the external executive labor market.

The aforementioned long interview period for internal candidates results in more detailed and historical performance data. This may put internal candidates at a disadvantage and lead to the inadvertent glorification of an external candidate of whom the board is less aware. At the same time, comparisons to external candidates can provide the board with improved developmental goals for internal candidates, as well as knowledge of unusually skilled outsiders who may suddenly be needed in future times of strategic upheaval or dramatic declines in performance.

The best-managed companies anticipate future leadership qualities and groom them from within, reducing the need to look outside for a successor.

Using a Recruiter

The board should periodically explore the external market to assess the available talent for comparison to the internal talent. A common means of doing this is for the board to independently consult with an outside advisor familiar with the company's strengths and weaknesses, as well as the top executive talent pool in the external market. The consultant should inform the board of general trends in leadership qualities, and identify outsiders who might qualify for consideration for the position of CEO.

Alternatives or Adjuncts to Recruiting Firms

Whether or not a company uses a recruiter to find top talent, the search will certainly have an online component. Professional communities on LinkedIn offer easy access to biographical details on individuals who may be suitable for a particular executive position. This site and many others also afford the ability to post and respond to open positions at any level. While contact and vetting still require a high-level human talent, the Internet does offer shortcuts to information gathering. Internet searches can also lead searchers to registries of high-level candidates. Databases of director candidates also offer access to senior-level talent—often current or past CEOs. ▲

The Talent Stream

According to the *Report of the NACD Blue Ribbon Commission on Talent Development*:

> 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.[8]

Roles: Who Is Responsible for CEO Evaluation and Succession?

While directors play an important role in both CEO evaluation and succession, they work with others to fulfill their duties. In this module, we will take a close look at who does what in both areas, starting with evaluation.

The Role of the Board in CEO Evaluation

Performance reviews are necessary—especially for the CEO, who has broad job duties, a large span of control, and a high degree of discretion in decision making. Creating a board culture that promotes meaningful CEO evaluation takes more than zeal on the part of a few directors; it requires full commitment. Ideally, the evaluation process should be initiated by the CEO.

One of the most important roles a board can play in CEO evaluation is the development of a position description, which provides a basis for setting performance objectives by defining appropriate measures and standards of performance. This description can range from a short list of key expectations to a longer document describing how these expectations will be fulfilled. Steps in such a process might include the following:

- Establish the specific scope of the CEO's day-to-day role. Is there a chief operating officer (COO)? Does the CEO manage the company's external relations, leaving almost all operating duties to the COO? Does the CEO chair the board or is there a non-executive chairman? What does the board think the CEO should be doing?
- Have the CEO state what he or she believes are his or her key job duties and see if the board concurs. If not, work until agreement is reached.
- When agreement is reached, be sure the COO and board chairman (if they exist separately from the CEO) also agree.

Once defined, the position description may not change much from year to year, but should, nonetheless, be reviewed periodically to determine if adjustment is appropriate.

Working With the CEO on Performance Objectives

The CEO evaluation cycle begins in advance of the fiscal year, when the board and CEO work together to set performance objectives. Ideally, these objectives will be related to the company's business plan for the year and longer term plans as well. Performance objectives for the CEO should include both qualitative and quantitative performance factors. Refer to Module One for a sample list of items to evaluate, ranging from integrity to CEO-board relations. (For a CEO evaluation template, see Appendix C.)

The Role of the Board in CEO Succession

The board's involvement with CEO evaluation will lead to its work in CEO succession. Like evaluation, this requires multiple perspectives and a team effort. In any public company, independent directors must retain ultimate authority to conduct the process; however, they should consult with the CEO. This is especially critical in companies led by a founder or other individual who has exercised strong leadership over a long period of time, because in those situations the identity of the company is inextricably combined with that of its CEO. (Senior management also has an important role in the succession process, as discussed later in this module.)

The board approves and monitors the strategic direction of the company, uses that strategy to develop performance standards for the CEO, and measures the CEO's performance against those standards.[9] This places the board in the best position to control the

Creating a board culture that promotes meaningful CEO evaluation takes more than zeal on the part of a few directors; it requires full commitment.

succession process. The reality of the boardroom culture, however, is such that in the past, some directors have shown an inability or habitual lack of courage to challenge basic strategic assumptions of the CEO and management. Directors have often been unwilling to ask awkward questions and have failed to act promptly to prevent problems. This often occurs when the CEO dominates the selection and compensation of board members. (See the "Monarch" style in the sidebar, "Implications of CEO Departure Styles" on page 17.)

Action Steps

The following action steps can support an effective succession process:

- Hold regular executive sessions in which the executive committee discusses succession planning and the internal development of promising executives, both with and without the CEO present.
- Form a committee that plans and oversees the succession process. Historically this has been the compensation committee but many boards are creating a separate committee specifically dedicated to succession planning and other human resources issues. If the board decides to allocate the responsibility of managing the process to a standing committee or a specific search committee, it is important that the entire board stay involved and accountable.
- Assume an active role in evaluating possible successors, spending the time necessary to make informed judgments about their capabilities, potential, and readiness for promotion.
- Conduct a regular (at least annual) performance review of the CEO during which the directors privately review the CEO's performance and determine whether he or she should continue in that position. The results of this review should immediately be communicated to the CEO.
- Express concerns and opinions openly and honestly when discussing the CEO's performance or the quality of a potential successor.
- Ensure that board members collectively possess a portfolio of skills, expertise, and attributes that will qualify them to identify the leadership needs of the corporation and evaluate prospective CEO candidates.
- Avoid becoming mired in day-to-day company business or the twists and turns of company politics. In evaluating its role in the succession process, the board should

Board Diversity Can Improve CEO Succession Planning

More corporate boards are becoming increasingly diverse. According to the *2014–2015 NACD Public Company Governance Survey*, the majority of boards have at least one director who is a woman and/or a person belonging to a group that is currently counted as a racial or ethnic minority in the United States.[10] There is a strategic reason for this diversity.

As stated in the *Report of the NACD Blue Ribbon Commission on The Diverse Board*:

> Diversity of human capital is an accepted business value today. The business need for diversity is evident in the rapidly changing demographic profile of the United States as well as the continuing rise in purchasing power of women and various racial and ethnic groups. If not already recognized, businesses and boardrooms will need to be prepared for this shift. From shop floor to the boardroom, diversity has been associated with a number of positive results. These results include improved competitiveness and talent management, greater access to capital, more sustainable profits, and better relations with stakeholders.[11]

There is also a possible direct benefit to CEO succession planning. A diverse board may be more likely to recognize a diverse array of talent in senior management and outside candidates when it comes to selecting the company's next leader.

IMPLICATIONS OF CEO DEPARTURE STYLES[12]			
	EXITING CEO TRAITS	SUCCESSOR CEO CHALLENGES	BOARD IMPERATIVES
THE "MONARCH"	• Dedication to job. • Brilliant visionary but elongated term. • Narrow devotion to old vision. • Belief in irreplacability. • Concerned about loss of challenge and life mission. • Undermines succession process. • Delays formal plans and announcement.	• Predecessor demands obedience. • Difficult to challenge old visions. • Lacks independent identity and credibility.	• Separate identity of firm from image of CEO. • Consider removing CEO from board. • Avoid: —cronyism due to length of CEO/ board relationships; —a hand-picked successor who is intentionally weak; —selection of overtly flawed candidate; and —lack of internal benchmarking.
THE "GENERAL"	• Ready to assist in crisis but can exaggerate problems. • Reluctant to leave office. • Eager to return to office. • High concern for continued status. • Questions performance of successor in effort to remove.	• Strong internal candidates set up against each other for extreme hostility—fiefdoms. • Former mentor becomes tormentor. • Predecessor encourages board members and senior management to share disappointments with successor . • Small missteps magnified as huge errors.	• Find mentors on board for skill, relationships, and cultural guidance. • Avoid invented crises. • Establish clear performance benchmarks and exit timetable for CEO. • Limit excessive battles between CEO candidates intended for mutual destruction.
THE "AMBASSADOR"	• Tranquil passing of baton but excessive involvement in community and non-corporate interests. • Emphasizes continuity of command. • Gives insufficient guidance to successor. • Selects successor in his or her image but lacks needed skills.	• Awkward continued presence of old friendly predecessor. • Protégé needs knowledge, skills, and relationships beyond predecessor's world.	• Hold regular private sessions. • Challenge heir apparent to be benchmarked against external candidates. • Get successor a great deal of external exposure. • Ensure a wide array of trial assignments.
THE "GOVERNOR"	• Immediately moves to new career. • Has bounded term of office. • Allows free rein for successor.	• Horse race between candidates can become destructive. • Dilemma for subordinates—hitched wagon to rising star or to shooting star. • Innocent executives injured in line of fire. • Lack of continuity or completed mentoring. • Lack of fair referee during contest among candidates.	• Get to know candidates firsthand. • Encourage ground rules of fair competition for internal rivals. • Take time to find external savior and undervalue hidden internal talent. • Limit number of boards for departing CEOs in final years. • Ensure firewalls in succession process to protect next level of management. • Prepare for disappointment.

seek the views of the CEO and top managers, as well as its own members.

- Consider seeking outside advice and expertise in executive talent assessment and succession planning.
- Benchmark against outside talent and peers.

Working With the CEO in Succession Planning

The dynamic between the CEO and the board is a sensitive one. In many cases, the CEO also serves as chairman and is therefore responsible for setting the agenda and the scope and timing of the information provided to the directors.[13] This can make it difficult to raise the question of succession.

The CEO should know the company and the job better than anyone else. This crucial expertise is reason enough for the CEO to be included in the succession process, and many CEOs provide helpful guidance. Some nurture outstanding managers and give them a chance to learn and to prove themselves to the board and to other employees. Others show wisdom and diplomacy in selecting an "heir apparent" from among the top managers, and in giving this candidate the responsibility and respect he or she needs to prepare for the position.

On the other hand, there are many examples of failed CEO successions that are attributable to over-involvement by the departing CEO. Some CEOs simply cannot let go. The same qualities of perseverance and drive that make CEOs successful can also make it difficult for them to know when it is time to go. Some may bring on a series of designated heirs who are somehow always found to be inadequate. Others may establish overly public internal horse races that are divisive and distracting, or insist on staying on as a sort of "CEO emeritus," whether as chairman of the board or as a consultant to the company. Others may undercut the selection process by insisting on qualities that did more to validate their leadership than to address the company's current and future concerns.

Working With Senior Management on Succession Planning

Managers below the CEO level can provide crucial information about exactly what kind of leadership the company needs at the current time. In turn, they can provide the best candidates as well—themselves. In some situations, however, management may be apprehensive about providing important information to the board for fear of appearing disloyal to the incumbent CEO or to influential directors. In addition, just like the CEO, senior managers can have a conflict of interest in providing information about themselves because of a strong inclination to spin the story so that it makes them appear in a favorable light.

In its search to identify leading CEO candidates, the board should take an active role in familiarizing itself with top company senior executives, as well as with marketplace leaders who have strong potential. While the CEO and the company's human resources executive should strive to identify the talent in both senior and middle management ranks, the board should actively monitor the company's "bench strength" by looking at the results of a potential succession scenario three levels from the CEO.

Shareholders: The Ultimate Checks and Balances

Directors are fiduciaries for the corporation and its shareholders. As such, the board should remain attentive and responsive to shareholder concerns about the effectiveness and responsiveness of management. In many cases, poor corporate performance can be a trigger for a heightened level of energy and coordination among shareholders. But even in companies that are performing well, shareholders, along with others, can provide something of a check on CEO succession.

While their substantive involvement in the succession process will generally be limited, shareholders' presence can be a powerful reminder to the board and management that it is the directors who must take ultimate responsibility for the process. ▲

COMPARISON OF EVALUATION AND SUCCESSION RESPONSIBILITIES

DIRECTORS	CEO	MANAGEMENT
• Identify a board committee to oversee succession process. • Discuss succession issues on a regular basis. • Actively participate in candidate selection. • Maintain personal economic stake in company. • Ensure CEO has annual review. • Openly and honestly express views and opinions. • Maintain diversity of board composition. • Get to know the senior management team.	• Actively participate in the succession process. • Seek feedback from members of top management. • Consult outside models of corporate succession. • Ensure directors have access to senior management team.	• Participate in dialogues with the board to establish qualities required for the CEO position. • Inform the board about available resources within current management team.

MODULE FOUR

Turning Points: Selecting and Compensating the "Right" CEO

Selecting the right person at the right time to fulfill the CEO role is, in the end, the single most critical task for the board.

When seeking a successor to a CEO, the board should seek a CEO who fits the company's current and projected culture, understands the business strategy, and inspires others to follow where he or she leads. Moreover, the CEO succession process itself should be carefully tailored to reflect the organization's current business strategy and vision. This must be a flexible process that changes with the company's focus and direction.

The board needs to carefully approach the responsibility of choosing the right person at the appropriate time. In some situations extenuating circumstances may shorten the timeline, but the board should still ensure a thoughtful and thorough process since the cost of selecting a CEO that does not fit the company's needs is enormous.

Developing the Ideal Candidate Profile

The type of CEO needed will vary according to the challenges facing the company and the competencies required to meet them. The board should first develop a "profile of success" that establishes the specifications and requirements of the CEO position. While each profile will be unique, the basic approach and questions asked can be broadly applied. The following are several areas of CEO qualifications that can provide insight to the board.

- **Strategic imperatives**. The board should make a strategic assessment of the company, asking: "What must this company do well in order to succeed?" For example, consider a company that is shifting from being a manufacturer to an after-market services firm, or one that is going through a radical restructuring or a major culture shift. Together, the competitive assessment, the customer trends, and the long- and short-term challenges facing the company will all have important implications for shaping the leadership requirements at the top. The board can access the strategic assessment through any means available, such as work done by senior management, outside consultants, or other similar sources.
- **Business competencies.** The board should then determine the competencies, or skill sets, that are relevant to meet the company's strategic imperatives. What skills and types of experiences prepare executives to meet challenges facing the company? For example, is strategically managing complex change relevant? Should the CEO have experience leading a single profit and loss business or multiple profit and loss business units? What about moving from turnaround to a growth strategy, or having technological insights and prowess?
- **CEO success factors**. The board should also develop a clear view of how it will determine whether or not the CEO is successful. These expectations of the CEO should be expressed as a series of clear goals based on rigorous board discussions, and should include financial targets. The goals and targets should take into account the complexity of the organization, the scope of the CEO's role, and the general conditions of both the industry and the market, all of which can greatly influence success.
- **Behavioral requirements.** Has the board carefully considered the behaviors that are best suited to the task at hand? What type of person will meet the needs of the company? Is it critical that the person fit the culture, or is the culture an obstacle to be overcome through a fresh new style of leadership? What values are important to this company and its identity? Is this a hierarchical organization or one that relies more heavily on collaboration? These be-

havioral requirements should be clearly articulated in order to help guide the selection process.

Identifying Candidates

Having a stable of well-groomed, internally developed potential successor candidates is the hallmark of a well-managed talent development program. Nevertheless, boards often choose to cast a wide net when identifying candidates for CEO. (See Module Two.) As mentioned earlier, this process enables the board to benchmark the internal talent against possible external sources, and provides a slate of candidates that may be needed quickly in times of extreme change.

Assessing Candidates

Having a well-developed and properly researched process for assessing CEO candidates is as important a component as any in the decision-making process. Directors need to ask the right questions and be assured that the answers received are accurate and comprehensive. The questions should be provocative and penetrating both for the internal, as well as external candidates. It is critical that directors not get lost in the "politeness" of the process at the expense of gaining useful information about the candidates.

Directors can:

- Involve members of the board who are most skilled and experienced at interviewing and assessing talent.
- Consider using consultants experienced in assessing CEO-level talent who can work closely with the board in making the selection decision.
- Be sure that the references of external candidates have been checked carefully. The search firm can assist in this effort. In addition, after narrowing down the list of candidates, the board might want to do its own reference checking where appropriate to ensure a complete process.

Companies operate in diverse industries, target various market segments, experience several stages of growth, and focus on different short- and long-term goals. Each distinct corporate environment requires a CEO with professional qualifications and personal traits that enhance and complement the "personality" of the business. Therefore, each CEO search (including multiple searches within the same company) should be considered unique and crafted accordingly.

It is important to seek out sources of information and insight to ensure the new CEO will "fit" with the company's attributes. Possible sources include:

- The board.
- The incumbent CEO.
- Senior management and other key members of the management team.
- Consultants who have been involved with the company in the areas of strategy, organization, and talent.
- Executive search professionals.

The new CEO will assume the responsibility of leading the organization, planning for the future, ensuring fiscal solvency, and maintaining or improving the quality of services rendered and/or products developed. This requires an individual who is culturally compatible, strategically creative, intellectually resourceful, and highly motivated.

Questions the Board Can Ask to Start the CEO Selection Process

- What are the key challenges facing the company?
- What must the company do to accomplish its objectives?
- What are the leadership needs of the company?
- What must the CEO do extremely well in order for the company to achieve its goals?
- What specific characteristics must the CEO possess in order to achieve success?
- What cultural traits are necessary to lead the company forward?

Matching CEO Characteristics to Corporate Environments

Module One pointed out the importance of considering a company's stage of development and/or situation when identifying criteria for CEO evaluation. At the end of that module there was a list of situation-specific considerations in CEO evaluation for high-growth, turnaround, and merger situations, as well as in industries undergoing rapid change. Directors serving on boards in one of those situations can use the brief descriptions of desired traits as a tool for making a choice among equally impressive candidates.

The Final Step: Making the Decision

As stated earlier in this report, the hardest task of the succession planning process is picking the right person at the right time to best meet the needs of the company. Having a well-planned decision-making process can help directors make the best choice.

Actions to guide the selection process include:

- Hold a series of interviews with finalists to enrich the process and add to the quality of the decision. This is especially true if there is an external search under way. Having key members of the board or the selection committee hold individual interviews is most advisable. An interview with the selection committee as a whole will provide another valuable dimension.
- Schedule a board meeting to review all relevant information and impressions. Encourage questions and input from the entire board.
- Use the candidate profile to be certain that relevant criteria are front and center in the decision-making process. Explore the strength of each candidate in relation to the organizational and behavioral requirements for the job. This will help in choosing the candidate that best fits the company rather than the candidate who has the highest profile or the best track record on paper.

Words of Warning

Internal competition is inevitable—and it can be constructive. If handled poorly, however, a horse race succession process can be counterproductive and divisive, and can also lead to public embarrassment.

An extended transition period may help in preserving continuity, but it can also lead to confusion and divided loyalties.

Negotiating Compensation With a New CEO

In general, the basic goals of compensation packages are to attract, motivate, and retain the ideal talent and drive performance. In some situations, however, the selected CEO may be coming from an already profitable situation, making them more difficult to sway. Part of the process of persuasion requires intensity, focus, and compassion. Both internal and external CEO hires must find the position to be a fulfilling one with sufficient incentives to seek constant betterment of the enterprise. The overall objectives are:

- **Short term.** Attract the "right" CEO from inside or outside the organization.
- **Continuous.** Motivate the CEO to inspire the corporation to reach for greatness, bringing excitement and new standards of accomplishments.
- **Long term.** Align CEO total compensation to shareholder value.

To achieve these objectives, boards should not be bound by the previous CEO's compensation package. It is important that directors find a balance between forming impactful incentive plans with the long-term future of the company. For example, a CEO can be awarded a substantial stock option in lieu of other direct compensation when he or she is three years from retirement. These options will not vest until two years after retirement, giving incentive for the incumbent to find a successor who will add value to the company.

When developing the new CEO's compensation package, the board should make it difficult for the selected candidate to back out of negotiations. Critical action steps include:

- **Gather key data.** Establish a detailed knowledge of a candidate's current total compensation. Estimate the value of what a candidate forfeits if he or she leaves, such as bonuses and unvested options.
- **Create compelling value proposition.** Find out the candidate's key motivators. Learn the candidate's toughest barriers—financial and non-financial. Determine lifestyle issues (housing comparables, education factors for children, spouse profession, family hobbies, and interests). Determine a winning threshold—how to make "an offer he or she can't refuse."
- **Finalize negotiation.** If reasonable, stay within the general framework provided by candidate. Consider different combinations of salary level, options, stock, and bonuses. Align total compensation with shareholder interests. Ideally, stock options should be indexed to the company's peer group or the market as a whole, so that the new CEO will do well only if the company beats the competition. Directors should encourage the CEO to buy stock with his/her own money to establish credibility and commitment.

Ousting a CEO exacts an incredibly high cost—both to a company and to the reputation of its board. Thus the board must refrain from pushing a candidate CEO into accepting a position he or she does not want or isn't a good fit.

Before agreeing to a compensation package, the board must carefully consider what shareholders' responses will be. The advent of say on pay, as well as a number of final and pending rules affecting compensation disclosures, make careful compensation planning more critical than ever. ▲

Principles of Executive Compensation[14]

Principle 1: Independence
Make independence a bedrock of compensation committee philosophy. Ensure that committee membership, processes, and approaches are entirely independent from the CEO and management.

Principle 2: Fairness
Fairness is not readily defined or measured. Different companies may define fair pay in different ways. Nonetheless, each compensation committee should try to create pay packages that will pass the test of scrutiny for fairness, both internally and externally.

Principle 3: Link to Performance
In selecting performance measures, committees should link pay to desired outcomes that the individual can affect rather than to stock price alone.

Principle 4: Long-Term Value for Shareholders
Compensation committees should design pay packages that encourage long-term commitment to the organization's well-being. Tying bonuses, stock grants, or other incentive compensation to an increase in the company's long-term value can help align a CEO's personal financial interests with those of shareholders.

Principle 5: Transparency
Compensation committees should embrace a philosophy of transparency—full and clear disclosure. Compensation committee members need to learn the important facts about compensation arrangements, and then let shareholders know these facts in a timely manner.

MODULE FIVE

Passing the Torch: Announcing and Assimilating a New CEO

The board should also create plans for communications, transition, and assimilation to introduce constituencies to the new CEO, and to help the new CEO succeed.

The board's responsibility extends beyond creating and following a process for selecting the new CEO. The program should be designed to take into account factors, such as whether the CEO was sourced internally or externally, or whether the executive is new to the CEO role.

Disclosures About CEO Succession

Some companies voluntarily disclose their CEO succession process. (See Appendix E for an example.) Further, it is not uncommon for shareholders to ask for more information about CEO succession in the annual proxy statement. These requests may come in the form of proposals asking that the companies adopt and disclose detailed CEO succession planning policies. Resolutions may also request that the board develop criteria for the CEO position, identify and develop internal candidates, and use a formal assessment process to evaluate candidates.

According to the Securities and Exchange Commission (SEC), these kinds of resolutions are appropriate for a shareholder vote, and may not be excluded from proxy statements as ordinary business matters. As the SEC has stated: "CEO succession planning raises a significant policy issue regarding the governance of the corporation that transcends the day-to-day business matter of managing the workforce."[15]

Sample Disclosure About a New CEO

Any change in leadership in a public company is considered a material event that should be disclosed promptly on the 8-K Form.[16] Item 5.02 of the form instructs filers to make certain disclosures about the hiring or departure of a CEO, among other matters. The filing must note the date of the event and in the case of a new CEO some facts about the executive. Companies that plan to produce a press release can delay filing their 8-K until then. For sample 8-K and press release language about a new CEO appointment, (based on actual examples) see Appendix F.

Effective CEO-Board Communications

Effective programs for communications between the board and the CEO typically include:

- **Expectations regarding board communications and decision rights.** The board should be specific about the communication it requires and expects from the new CEO. This would include clarification of what decisions the board wants to be made aware of, what decisions should be subject to final board approval, and what decisions should be made by the board only.
- **Performance goals and expectations for the short term.** During the first year to 18 months of a CEO's tenure, the CEO will need to know exactly what the board expects. These goals and expectations can be taken from the dimensional analysis profile that was created to select the new CEO.
- **Committee-level orientation.** Each committee chair should brief the new CEO on the workings of that committee: the charter, a history of what the committee has been doing, and current issues and activities.
- **Board support for change.** High-performing CEOs take charge and this often includes change. Policies will change, people will change, and cultures will be impacted during early transition periods. Long-standing board members must avoid over-reacting to appropriate levels of change. Support, not micro-management, will be the key to success.

- **Board composition and membership**. The board should initiate early and open discussions with the CEO about board composition. While director selection should remain independent with the nominating committee, the committee should seek input from the new CEO about his or her view on ideal business competencies for the board with respect to the company's strategic goals.
- **Role clarification.** If the board has a non-executive chairman or lead director, it should explain these roles to the CEO to avoid misunderstandings.

New CEO Assimilation

Once the board has selected the new CEO, it is important to designate a director as champion of assimilating him or her to the new role. Often, the head of the selection committee takes on this role. Regardless of who is designated, this board member serves as a key resource to the new CEO during the critical early months of assimilation.

Responsibilities include:

- Meet with the new CEO periodically to see how things are going and to help establish a communication pattern consistent with the board's expectations.
- Work with the board to determine how various members could be most helpful to the new CEO, depending on their particular background, skills, and familiarity with certain aspects of the company and the industry.
- Develop an orientation plan with the new CEO to identify the kind of help that can be most beneficial.
- Take the lead in educating the new CEO on the backgrounds and expertise of the various board members.
- Help foster a good relationship with the board and deal with misunderstandings that could undermine trust and confidence.

Into the Future

Having gone through the transition phase and assimilated the new CEO, the board's work continues as it seeks to ensure that the new CEO is meeting the leadership needs of the company and is supported by a developed talent pool.

First-Year Timeline of Selection and Transition Events

Candidates Being Considered

- Identify complementary skills within management that would combine to create a successful team.
- Identify development needs.
- Create a profile of success.

Candidate Chosen

- Provide the candidate with a clear job description.
- Explain performance measurements to which the CEO will be held accountable.

New CEO Begins

- Support new CEO through onboarding, mentoring, and providing a clear scope of authority (e.g., emphasize that there is no need to compete with the recent incumbent for power).
- Work to recognize, reward, and retain internal candidates not chosen for the job.
- Create an emergency backup plan.
- Consider long-range succession planning.
- Begin identifying management team members with leadership potential.

Mid-Year Review

- Evaluate the CEO's performance.
- Share results with the CEO.
- Identify developmental needs and create a plan to meet those needs.
- Discuss top management leadership qualities.
- Reassess emergency plan.
- Continue to cultivate strong leaders in the company.
- Consider perspective of CEO/other leaders—work on retention.

Annual Review

- Evaluate performance.
- Share results with the CEO.
- Create a development plan.

Once the board has selected the new CEO, the work does not stop. Directors cannot abandon their chief responsibility as fiduciaries who represent the shareholders: ensuring that the company has the "right" leader at the right time—not only today, but in the future. ▲

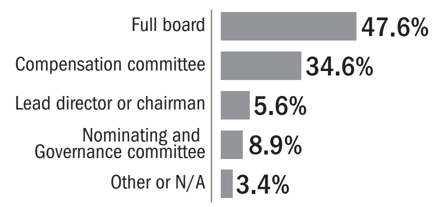
CEO Evaluation and Succession Planning Data

In the *2014–2015 NACD Public Company Governance Survey*, respondents were asked to identify their top-3 priorities out of 20 provided choices. The most commonly identified priorities were strategy, performance, and CEO succession, with risk oversight and talent development ranking four and five. Specifically:

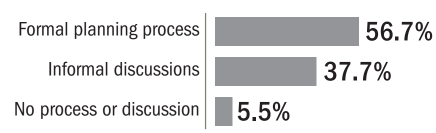
- 28.6 percent of respondents reported CEO succession as a "top-three" priority, and
- 21.6 percent named executive talent and leadership development a "top-three" priority.

Although outranked by strategy—which was chosen by 54.7 percent of respondents—these human capital goals ranked significantly higher than other priorities, namely: financial oversight and internal controls; and director recruitment and succession, each of which received less than 20 percent of top-three rankings. CEO compensation ranked much lower, with only 9.1 percent selecting this as a high priority. Just 5.6 percent of respondents identified CEO evaluation as a top priority.

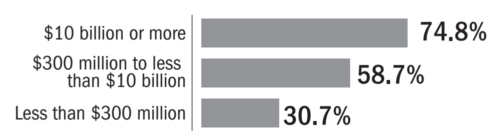
Who is primarily responsible for conducting CEO evaluation? (only one answer permitted):



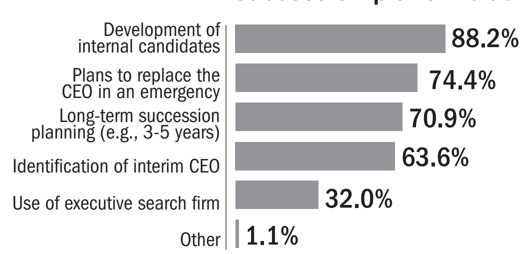
How does your board approach CEO succession planning?



Prevalence of formal CEO succession plans by company size



Regardless of formality, CEO succession plans include:



Source: National Association of Corporate Directors (NACD), *2014–2015 NACD Public Company Governance Survey* (Washington DC: NACD, 2014) (a report of the NACD Blue Ribbon Commission).

APPENDIX B

Elements of a Sample Position Description for the CEO

- Fosters a corporate culture that promotes ethical practices, encourages individual integrity, and fulfills social responsibility.
- Maintains a positive and ethical work climate that is conducive to attracting, retaining, and motivating a diverse group of top-quality employees at all levels.
- Develops and recommends to the board a long-term strategy and vision for the company that leads to creation of shareholder value.
- Develops and recommends to the board annual business plans and budgets that support the company's long-term strategy.
- Ensures that the day-to-day business affairs of the company are appropriately managed.
- Consistently strives to achieve the company's financial and operating goals and objectives.
- Ensures continuous improvement in the quality and value of the products and services provided by the company.
- Ensures that the company achieves and maintains a satisfactory competitive position within its industry.
- Ensures that the company has an effective management team below the level of the CEO, and has an active plan for its development and succession.
- Ensures, in cooperation with the board, that there is an effective succession plan in place for the CEO position.
- Formulates and oversees the implementation of major corporate policies.
- Serves as the chief spokesperson for the company.

Note: This description does not include chairman, president, or chief operating officer duties.

APPENDIX C

Sample Template for CEO Evaluation

(Template focusing on priorities using a five-point ascending scale)[17]

CEO Performance Evaluation

CEO Name ____

Evaluator's Name ______________________________________

Review Period ____

I. Overall Assessment

On a scale of 1 to 5, where 1 is "unsatisfactory," 3 is "meets expectations," and 5 is "outstanding," please rate the CEO's performance during the past year.

Integrity. The CEO sets the tone for the company by exemplifying consistent values of high ethical awareness, honesty, fairness, and courage. The CEO's conduct is becoming to the office of the CEO.

Vision. The CEO has articulated a clear vision for the company that makes good business sense. The CEO's visions provide a solid foundation for building the business. Operating plans reflect this vision.

Leadership. The CEO leads the company and sets a philosophy that is well understood, widely supported, consistently applied, and effectively implemented; sets standards for strong safety and ethical compliance. The CEO has built a stronger organization where productivity, morale, teamwork, and operations all show measurable improvement.

Strategic planning. The CEO ensures the development of a long-term strategy; establishes objectives and plans that meet the needs of shareholders, customers, employees, and all corporate stakeholders; ensures consistent and timely progress toward strategic objectives; obtains and allocates resources consistent with strategic objectives.

Financial results. The CEO establishes appropriate annual financial goals and longer term financial objectives, and manages to consistently achieve these goals; ensures that appropriate accounting systems are maintained to protect assets and maintain effective control of operations.

Succession planning. The CEO develops, attracts, retains, motivates, and supervises an effective top management team capable of achieving objectives; provides for management succession.

Human resources and diversity. The CEO ensures the development of effective recruitment, training, retention, and personnel communications plans and programs to provide and motivate the necessary human resources to achieve objectives; establishes and monitors diversity programs to provide equal opportunity employment for all employees.

Communications. The CEO serves as chief spokesperson, communicating effectively with shareholders and all stakeholders.

Stakeholder relations. Ensures that the company and its operating units contribute appropriately to the well-being of their communities and industries. Represents the company in community and industry affairs.

Board relations. The CEO builds positive relationships with board members and helps strengthen the board, working closely with directors to keep them fully informed on all important aspects of the status and development of the company. The CEO facilitates the board's governance, and implements approved board policies, while recommending policies for board consideration.

II. Strategic Planning and Risk Management

The following are components of the current strategic plan, expressed as opportunities and risks. Please use the same 1–5 rating system as above to rate the CEO's effectiveness at pursuing the opportunities and protecting against the risks.

Opportunity 1.

Opportunity 2.

Risk 1.

Risk 2.

III. Corporate Financial and Business Performance

Please use the same 1-5 rating system for the questions below:

How would you rank the CEO's performance in the following areas of company financial and/or quantitative performance:

Assets (including asset-based ratios such as return on assets (ROA))

Cash flow

Containment of expenses

Dividend payments

Earnings (including earnings before interest, taxes, depreciation, and amortization (EBITDA); net income; and operating income)

Earnings-based ratios such as earnings per share (EPS); return on equity (ROE); return on investment capital (ROIC); and ROA

Growth in sales (revenue)

Hybrid measures such as economic value added (EVA)

Stock price

Total shareholder return (TSR)

How would you rank the CEO's performance in the following areas of company business/qualitative performance:

Business development

Community engagement

Competition (e.g., increasing market share)

Customer satisfaction and loyalty

Environmental compliance and practices,

Health and safety

Human capital (e.g., recruiting and developing talent)

Innovation

Legal compliance

Operations

Product quality

Service quality

Reputation

"Tone at the Top"

Additional comments on leadership ____

____

IV. Opportunities for CEO Development

Please suggest areas for additional professional development for the CEO to support the company's continued achievement of our strategic goals:____

____

Additional comments on opportunities for growth?____________________________________

____

V. Overall Rating of the CEO

Overall, how satisfied are you with the CEO's leadership?

Strengths____

Areas of improvement ____

Additional comments on overall satisfaction?_______________________________________

____

VI. Key Challenges in the Year to Come

Please add any notes on key challenges your company faces, and how you believe the CEO can best help the company face them.

____

____

APPENDIX D

Sample CEO Succession Process

Succession Planning Process[18]

1. Determine criteria or qualifications for the CEO's successor.
  a. Envision challenges facing the company's CEO in the next 5 to 10 years.
  b. Identify qualities and skills needed to meet those challenges.
  c. Develop rating process to evaluate candidates against the criteria.

2. Identify possible candidates for succession.
  a. CEO and board agree on individuals to be considered as possible successors.

3. Assess the capability and potential of possible successors.
  a. CEO and board members complete assessments of each candidate.
  b. Tabulate ratings for collective view of candidates.
  c. Board members review assessments and share views.
    i. Seek consensus about the candidates: specific and overall conclusions.
    ii. Identify the points of difference that need to be reconciled.
    iii. Identify what needs to be learned about candidates.

4. Complete development action plans.
  a. to prepare the candidates for promotion.
  b. to further test their viability as successors and readiness for promotion.

5. Review progress.
  a. Update assessment and conclusions about promotability.
    i. Identify what has been learned about candidates.
    ii. Consider if experiences have improved readiness.
    iii. Identify additional developmental actions.
  b. Reconsider availability of viable candidates.

Evaluation Process

The purpose of this process is to help develop an objective and in-depth picture of possible CEO successors and to provide an appropriate basis to draw sound conclusions about their future effectiveness as the company's CEO. The evaluation should consider a vision of the challenges and requirements that are likely to be faced by the next CEO in continuing the growth and success of the company. The evaluation includes two parts:

1. Ratings. Using an ascending scale of 1 to 5, with 5 being the highest and 1 being the lowest, evaluate the candidate on each of the dimensions listed indicating (a) the evaluation rating and (b) the extent to which you have had the opportunity to observe and draw conclusions about that factor. The definitions of the ratings are provided on the next page.

The "comments" section is for your convenience to note issues you might wish to raise about the executive.

2. Overall conclusions. Indicate your overall conclusions about the executive's capability, promotability, and potential. Provide the specific observations that were critical to your conclusions. Also indicate what more you would like to learn about the executive and provide suggestions for the executive's continued development.

A rating worksheet has also been provided to help with the rating process. The worksheet lists the various qualities or characteristics that should be considered in the evaluation. They are, in effect, operational definitions of the dimensions being rated.

Executive Evaluation

Definitions of Ratings

Ratings. Evaluate executive in terms of the capability to lead a large, complex, diversified, high-growth, high-performance public corporation.

5 – Exceptional. Clearly sets individual apart from other senior executives. Provides ability to make unique, exceptional contributions.

4 – Good. Skillful; performs effectively. Enables person to be valuable contributor.

3 – Adequate. Competent, though not a distinguishing quality. Does not provide exceptional competitive advantage compared to others.

2 – Needs Development. Warrants improvement to meet the demands of the job. Can be developed through experience, guidance, or training.

1 – Limited. Has fundamental weaknesses that inhibit success in the position. Improvement not likely to be realized.

Opportunity to observe. How much opportunity have you had to observe and evaluate the executive on the particular dimension?

1 – Extensive opportunity to evaluate effectiveness.

2 – Reasonable opportunity to draw conclusions.

3 – Additional exposure needed to validate conclusions.

4 – Insufficient opportunity to make judgment.

Ratings of Executive

Name of executive____

Name of evaluator____

Date____

Opportunity____

Ratings to observe comments____

1. Personal Values

Core values __________

Personal integrity __________

2. Motivation

Drive to achieve __________

Entrepreneurial spirit __________

Temperament/stability __________

3. Thinking and Problem Solving
Intellectual capacity __________

Strategic thinking __________

Problem solving __________

Decision making __________

4. Interpersonal
Interpersonal skills __________

Team skills __________

Constituency relations __________

5. Leadership
Vision for organization __________

Influence on employees __________

Development of executive organization _______

Effectiveness with board __________

6. Business Management
General management experience __________

Business knowledge and skills __________

Capacity to make money __________

Support and control __________

Overall Conclusions

Name of candidate____

For each item below, check the response that best describes your conclusion.

Opportunity to Observe

How much opportunity have you had to evaluate the candidate's overall potential?

Extensive _____ Reasonably More Opportunity _____ Sufficient _____ Insufficient _____

Comments ____
____
____

Overall Capability
How would you rate the candidate's overall capability as an executive?

Exceptional _____ Good _____ Adequate _____ Needs Limited Development _____

Comments ____
____
____
____

Promotability
How soon will the executive be ready to function as CEO?

Now _____ 1-2 years _____ 3-4 years _____ 5-10 years _____

Candidate unlikely to function as CEO _______

How soon will the executive be ready to function as president and/or chief operating officer?

Now _____ 1-2 years _____ 3-4 years _____ 5-10 years _____ Unlikely _____

Comments ____
____
____
____

Future CEO Potential

How good a CEO do you think this executive can become?

Exceptional _____ Good _____ Adequate _____ Marginal _____ Poor _____

Comments ____
____
____
____

Strengths. What strengths could enable the executive to be an effective CEO?

____
____
____

Concerns. What weaknesses could limit the executive from being an effective CEO?

____
____
____

Additional Knowledge. What more would you like to know about the executive?

____
____
____

Developmental Actions. What suggestions do you have for the executive's development?

____
____
____

Composite Picture of Board's Ratings

NOTE: Complete this form after the board members have done their evaluations. For each line, put name of rater and the number the rater has given, for example: Mary 5, Robert 5, Paul 4, Ira 3, Liam 4, Jane 5, Diane 5, Earle, 4, Lucas, 5. This can be represented graphically (see box below).

This example shows how the board rated their CEO.

1. PERSONAL VALUES

Core values	5	5	4	3	4	5	5	4	5
	Mary	Robert	Paul	Ira	Liam	Jane	Diane	Earle	Lucas

1. Personal Values

Core values ___ ___ ___ ___ ___ ___ ___ ___ ___

Personal integrity ___ ___ ___ ___ ___ ___ ___ ___ ___

2. Motivation

Drive to achieve ___ ___ ___ ___ ___ ___ ___ ___ ___

Entrepreneurial spirit ___ ___ ___ ___ ___ ___ ___ ___ ___

Temperament/stability ___ ___ ___ ___ ___ ___ ___ ___ ___

3. Thinking and Problem Solving

Intellectual capacity ___ ___ ___ ___ ___ ___ ___ ___ ___

Strategic thinking ___ ___ ___ ___ ___ ___ ___ ___ ___

Problem solving ___ ___ ___ ___ ___ ___ ___ ___ ___

Decision making ___ ___ ___ ___ ___ ___ ___ ___ ___

4. Interpersonal

Interpersonal skills ___ ___ ___ ___ ___ ___ ___ ___ ___

Team skills ___ ___ ___ ___ ___ ___ ___ ___ ___ ___

Constituency relations ___ ___ ___ ___ ___ ___ ___ ___ ___

5. Leadership

Vision for organization ___ ___ ___ ___ ___ ___ ___ ___ ___

Influence on employees ___ ___ ___ ___ ___ ___ ___ ___ ___

Development of executive organization ___ ___ ___ ___ ___ ___ ___ ___ ___

Effectiveness with board ___ ___ ___ ___ ___ ___ ___ ___ ___

6. Business Management

General management experience ___ ___ ___ ___ ___ ___ ___ ___ ___

Business knowledge and skills ___ ___ ___ ___ ___ ___ ___ ___ ___

Capacity to make money ___ ___ ___ ___ ___ ___ ___ ___ ___

Support and control ___ ___ ___ ___ ___ ___ ___ ___ ___

Name of Executive____

Date_______________________________

APPENDIX E

Sample CEO Succession Disclosure

(Excerpted from Intel's 2012 proxy statement)[19]

The Board's Role in Succession Planning

As reflected in our Corporate Governance Guidelines, the board's primary responsibilities include planning for succession with respect to the position of CEO and monitoring and advising on management's succession planning for other executive officers. The board's goal is to have a long-term and continuing program for effective senior leadership development and succession. The board also has short-term contingency plans in place for emergency and ordinary-course contingencies, such as the departure, death, or disability of the CEO or other executive officers.

As part of the CEO succession planning process, the CEO and the board have created a statement of core capabilities that the board seeks in a CEO succession candidate. Those abilities address the areas of strategy, leadership, and execution. The CEO also oversees development of a similar statement of core capabilities for other executive officer positions. These statements are reviewed and revised on a periodic basis to take into account the evolution of Intel's long-term business strategy. These lists of capabilities serve as a basis for identifying and conducting assessments of the skills and development of potential internal candidates for the CEO and other executive officer positions.

Periodically during the year, the CEO and the director of human resources discuss with the full board a variety of workforce and management succession topics, including, for example, worldwide workforce demographics, hiring programs, workforce retention, CEO succession candidates, next-generation leadership development, non-U.S. leadership development, and external hiring initiatives for senior positions. The board's periodic reviews of the CEO succession planning process include a review of specific individuals identified as active CEO succession candidates. Each of those individuals is reviewed with respect to progress in current job position and progress toward meeting defined development goals in strategy, leadership, and execution. The company's senior leaders are similarly responsible for working on next generation leadership development through the identification of personnel deemed important to Intel; identifying the skills and capabilities of future leaders; assessing the individuals against leadership capabilities; identifying skills and experience gaps and development needs; sponsoring internal candidate development; and identifying important external-hire needs.

Officers regularly attend board meetings to present information on our business and strategy. The board and individual directors meet with, advise, and assist CEO succession candidates and become familiar with other senior and next generation leaders through these meetings and other processes. Our officers work with a leadership consulting firm to receive input on personal, interpersonal, and organizational issues that contribute to leadership development. Our directors are expected to become sufficiently familiar with Intel's executive officers to be able to provide perspective on the experience, capabilities, and performance of potential CEO candidates. Each of the CEO succession candidates has one or more designated board mentors for advice and development purposes. Board meetings are planned to specifically include presentations by active succession candidates and other senior leaders in the company.

APPENDIX F

Introducing the New CEO

Sample 8-K Announcement of a New CEO[20]

Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.

On July 25, 2014, ABC Company (the Company) announced that its Board of Directors has appointed Carl Williams as President and Chief Executive Officer effective September 1, 2014. Mr. Williams will succeed Ann Jones, who has served as the Company's Interim President and Chief Executive Officer since September 1, 2013. Beginning August 1, Ms. Jones will be named to a new position as Senior Vice President and Chief Strategy Officer. Regan Wallace, currently Vice President of Operations, will succeed Mr. Williams as COO.

Williams, age 52, currently serves as Chief Operating Officer of ABC and has served in that role since 2010. He has served the company in a variety of capacities, including regional sales manager, director of cross-marketing, and other roles. Prior to joining ABC, he served as a sales associate of XYZ prior to its merger with ABC in 2003, and was named to the M&A integration team that year.

As the Bank's President and Chief Executive Officer, Mr. Williams will be paid an annual base salary of $950,000 and he will be eligible to participate in the company's senior officer pay plans. [Detail omitted]. Mr. Williams' maximum potential incentive award will be 60 percent of his base salary. In addition, the Company will pay Mr. Williams a hiring bonus of $250,000, payable upon completion of his first full month of employment.

A copy of the press release announcing Mr. Williams' appointment as the Bank's President and Chief Executive Officer is attached to this Current Report on Form 8-K as Exhibit 99.1.

Actual Press Release About a New CEO[21]

PRESS RELEASE

Susan Desmond-Hellmann Named Chief Executive Officer of the Bill & Melinda Gates Foundation

SEATTLE, WA (December 17, 2013) — The Bill & Melinda Gates Foundation has selected Susan Desmond-Hellmann as its next chief executive officer. Currently the chancellor of the University of California, San Francisco, Desmond-Hellmann will assume her role on May 1, 2014.

"We chose Sue because of her scientific knowledge and deep technical expertise on the foundation's issues, as well as the organizational and leadership skills required to lead a large, growing, and dynamic global organization. She shares our commitment and passion to create a more equitable world," said Melinda Gates, co-chair of the foundation.

"I am honored by the opportunity that Bill and Melinda have extended to me. I'm excited to join such a dynamic and ambitious organization, with such a clear and focused mission—improving the lives of the world's most vulnerbale," said Desmond-Hellmann.

An oncologist by training, Desmond-Hellmann is a recognized leader on issues of higher education, public policy, drug development, regulatory innovation, and health policy.

About the Bill & Melinda Gates Foundation

Guided by the belief that every life has equal value, the Bill & Melinda Gates Foundation works to help all people lead healthy, productive lives, In developing countries, it focuses on improving people's health and giving them the chance to lift themselves out of hunger and extreme poverty.

Contact: media@gatesfoundation.org
206-709-3400

Endnotes

[1] The *2014–2015 NACD Public Company Governance Survey* asked respondents to identify their top-3 upcoming priorities out of 20 (including "Other"). Approximately 28.6 percent of respondents identified CEO succession as a top-three issue, and 21.6 percent identified executive talent development as such. Strategy, corporate performance, and risk oversight rounded out the top five. *See* National Association of Corporate Directors (NACD), *2014–2015 NACD Public Company Governance Survey* (Washington DC: NACD, 2014) [hereinafter *2014–2015 NACD Public Company Governance Survey*].

[2] Section 953(a) of the Wall Street Reform and Consumer Protection Act, known as Dodd-Frank, says that when disclosing executive compensation in the proxy, companies must also discuss the relationship between compensation "actually received" and the financial performance of the company, "taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions."

[3] National Association of Corporate Directors (NACD), *Performance Metrics* (Washington DC: NACD, 2010) (a report of the NACD Blue Ribbon Commission).

[4] Jeffrey Sonnenfeld, Yale University School of Management. The following discussion is based on a template provided by Jeffrey Sonnenfeld. It has been adapted for this handbook with his permission.

[5] For an article on CEO succession that emphasizes the CEO as a "top talent officer," see Robin Rauzi, "Being Prepared for Whatever, Whenever," *NACD Directorship*, Sept./Oct. 2012, 44-49, 46, with a profile of MasterCard CEO Ajay Banga, interviewed by Jane Stevenson of Korn Ferry. In this same issue, also see Barry Adler, "The Unlikely Successor," 50-51.

[6] These principles are based on the original edition of National Association of Corporate Directors (NACD), *CEO Succession* (Washington DC: NACD, 1998) (a report of the NACD Blue Ribbon Commission).

[7] Source: Jeffrey Sonnenfeld and John Ward.

[8] This passage is based on National Association of Corporate Directors (NACD), *Talent Development: A Boardroom Imperative* (Washington DC: NACD, 2013) (a report of the NACD Blue Ribbon Commission) [hereinafter *Talent Development*].

[9] *See id*.

[10] *See supra* note 1.

[11] National Association of Corporate Directors (NACD), *The Diverse Board: Moving From Interest to Action* (Washington DC: NACD, 2012) (a report of the NACD Blue Ribbon Commission).

[12] *See Talent Development*, *supra* note 8.

[13] Prevalence of combined CEO-chair in 2013 was 57.1 percent for companies with a market cap of over $200 billion, 42.2 percent for companies with a market cap between $2 billion and $200 billion, and 37.7 percent for smaller cap companies. *See 2014–2015 NACD Public Company Governance Survey*, *supra* note 1.

[14] National Association of Corporate Directors (NACD), *Executive Compensation and the Role of the Compensation Committee* (Washington DC: NACD, 2003, 2007, 2014 (forthcoming)) (a report of the NACD Blue Ribbon Commission).

[15] The SEC has stated that "one of the board's key functions is to provide for succession planning so that the company is not adversely affected due to a vacancy in leadership. Securities and Exchange Commission (SEC), "Shareholder Proposals: Staff Legal Bulletin No. 14E (CF)," Oct. 27, 2009.

[16] As this form states, in part:

> If the registrant's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or any person performing similar functions, or any named executive officer, retires, resigns, or is terminated from that position, or if a director retires, resigns, is removed, or refuses to stand for re-election…disclose the fact that the event has occurred and the date of the event.

> If the registrant appoints a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or person performing similar functions, disclose the following information with respect to the newly appointed officer:
>
> (1) the name and position of the newly appointed officer and the date of the appointment;
>
> (2) the information required by [certain items in] Regulation S-K; and
>
> (3) a brief description of any material plan, contract or arrangement (whether or not written) to which a covered officer is a party or in which he or she participates that is entered into or material amendment in connection with the triggering event or any grant or award to any such covered person or modification thereto, under any such plan, contract or arrangement in connection with any such event.

[17] This template is based on NACD's review of a number of templates over time in a variety of companies. Boards should customize it to their situations. For example, a board involved in a merger could add in the considerations needed for a merger leader (from the end of Module One). For additional formats, see, for example, Jay W. Lorsch and Alexis Chernak, "Board of Directors of Medtronic Inc.," Harvard Business School Case 407-045, September 2006 (revised November 2007). Priorities are based on those identified in the *2013–2014 NACD Public Company Governance Survey,* as well as numerous CEO evaluation templates studied. Boards are encouraged to substitute their own priorities.

[18] The chief developer of this process was Richard Gould, who served as a resource to the original NACD Blue Ribbon Commission on CEO Succession, chaired by Jeffrey Sonnenfeld and convened in 1998.

[19] Intel Corp., *2012 Proxy Statement*, Apr. 4, 2012, www.intc.com/intelProxy2012/common/pdfs/Intel_2012_Proxy_Statement.pdf.

[20] Securities and Exchange Commission, *Form 8-K*, www.sec.gov/about/forms/form8-k.pdf.

[21] The press release used in this handbook is an abridged version of the actual one. For the entire press release, see Press Release, Susan Desmond-Hellmann Named Chief Executive Officer of the Bill & Melinda Gates Foundation (Dec. 17, 2013), www.gatesfoundation.org/Media-Center/Press-Releases/2013/12/Susan-Desmond-Hellmann-Named-Chief-Executive-Officer-of-the-Bill-and-Melinda-Gates-Foundation.

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