HEIDRICK & STRUGGLES

BOARD OF DIRECTORS PRACTICE

GENERATIONAL DYNAMICS

How boards tackle succession

Generational change offers boards the opportunity to improve their performance and increase diversity. A survey of global board members suggests there is little consensus on how to seize the opportunities.

Generational dynamics

How boards tackle succession

With Baby Boomer-aged company directors at the helm of many corporate boards, and their predecessors starting to retire, boards have an unprecedented opportunity to increase their diversity and improve their performance. But the question for many boards remains: how to bring about the necessary changes? Conversations with underperforming directors of any age are difficult, and while younger board members may be more likely to have desirable skills (for example, digital savvy), they don't have the same levels of business experience as do more seasoned directors.

This year's Heidrick & Struggles Board of Directors Survey,[1] the fifth in an ongoing series, found that boards are ambivalent about using age limits as a trigger for renewal, with only 37% of directors implementing such limits, despite more than half saying they supported them in our 2013 survey. Meanwhile, among boards that have age limits, some 15% of directors admit they have made exceptions to them in the recent past.

Increasingly, board chairs favor evaluations of the full board (90% in 2014, up from 84% the previous year) and annual evaluations of individual directors (53%). When it comes to satisfaction levels with director evaluations, fully two-thirds of directors describe them as "robust," although a surprisingly large proportion of directors (23%) admit they are "perfunctory." Nonetheless, director evaluations are viewed as a powerful tool for change, and 38% of directors in our latest survey indicate that their boards have removed underperforming members in the past few years.

In 2013, only a slim majority of directors (54%) felt their boards were either "effective" or "somewhat effective" in exiting respected directors who no longer fit current needs, while one in five said the board was "ineffective" or "somewhat ineffective."

1 The survey was conducted in November 2014 and included 487 corporate board members from around the world. For last year's survey see, *2013 Board of Directors Survey: The state of leadership succession planning today*, www.heidrick.com, March 17, 2014.

It's not the age, it's the sage

Almost one-quarter of respondents in our 2014 survey said they had increased the existing age limit of board members; 70 to 75 years old was generally considered the upper range for effective governance. That age limit represents little change from last year's survey, in which 65% of those surveyed gave 70 to 74 years old as the ideal retirement ages, with 23% suggesting ages 75 and older. Only 11% suggested 65 to 69 years old as the preferred age range for departure.

Comments from our latest survey on the question, "Does your board have an age limit?" range from "Nothing written, but we would comply with the legal guidelines [of a] max [of] 70 years" to "Not officially, but informally in the mid-70s" and "Our 10-year tenure limit makes it unnecessary."

Anti-ageism laws in some countries prohibit limits, but in the words of one director, "Around 70 would be the de facto limit, although it is not necessary to specify it." Another director admitted that age limits had been used successfully to remove directors and make the board more effective.

Still, the words of another leading chairman resonate strongly with the views of many directors: "I don't believe age has anything to do with sound judgment and competency," this director observed. "I also don't need to use age as an excuse to rotate out lower-performing independent board members."

Mandated term limits are generally not popular, with boards wanting to determine tenures, and about two-thirds of respondents had not even discussed the idea of implementing them. Even when term limits are stipulated (say, three years), many say they renew the term multiple times (nine to ten years on a board is considered optimal). One director says, "We don't have a hard limit, but we do look more critically at a director's ongoing added value after 10 years." Other typical comments included:

- "Term is not an appropriate criteria — objective and constructive contribution is key."
- "[We] want to use performance appraisals as the guide."

We agree that age is not the issue. In our experience, it's all about judgment, and while many companies desire older board members who can play the role of "wise counselor" to a board, we also routinely encounter younger directors who have wisdom or expertise beyond their years.

For example, at least three Fortune 500 companies in North America have recently added directors under the age of 35, and BMW in Germany replaced the chairmen of both its board of management and supervisory board with younger directors, aged 49 and 58, respectively. In announcing the move, the deputy chairman of the supervisory board, Stefan Quandt, called it "a generational change which combines the need for continuity and experience with the creative energy of the younger generation.[2]

Younger board members are effectively acting as a bridge between the Baby Boomers and the biggest demographic wave in history — the 86-million-strong Millennials, including Generation Y — who already outnumber the Baby Boomers and account for some US$1.3 trillion of all consumer spending (21% of the market).[3]

Digital experience is coming to the fore. At a recent seminar conducted by Heidrick & Struggles in Australia, Catherine Livingstone, chairperson of the telco giant Telstra, spoke of the demographic dilemma facing boards when she asked:

"When we talk about the age of our board members, clearly our generation wasn't born digital, so the question is, do you appoint someone to the board who has deep current technology experience but who may not fully

2 See the press release "BMW Group takes steps to initiate a generational change at the head of the Board of Management and Supervisory Board," www.press.bmwgroup.com, September 12, 2014.

3 See Jacqueline Doherty, "On the Rise," www.barrons.com, April 29, 2013.

2014 BOARD OF DIRECTORS SURVEY

Generational dynamics

How boards tackle succession

SURVEY DEMOGRAPHICS (487 RESPONDENTS)

86% Male **14%** Female

85% Publicly traded **15%** Private

Does your board conduct annual board evaluations?

Are they a useful tool?

Do you conduct individual director evaluations on an annual basis?

If **yes**, are they robust or perfunctory?

"The real answer is, 'In between these two answers'"

Survey respondent

Does your board have an age limit?

No **59%**
Yes **37%**
Don't know **4%**

If **yes**, have you raised/lowered it in recent years or are you considering doing so?

65%
No change

24%
Raised

11%
Lowered

"Age limits were in place, but have been changed, given the changing demographic."

Survey respondent

Have you waived this limit on behalf of a director in the recent past?

No **76%**
Yes **15%**
Not applicable **7%**
No age limit **2%**

Does your board have term limits in place today?

No **64%**
Yes **35%**
Don't know **1%**

If **no**, have you discussed implementing them?

No **65%**
Yes **32%**
Don't know **3%**

"We are putting in term limits of 15 years rather than age limits"

Survey respondent

Have you had to counsel a director off the board in the past few years?

No **59%**
Yes **38%**
Don't know **3%**

understand the business judgment call that is required? Or do you appoint someone who doesn't have the immediately current technology experience but who has a depth of business experience?"[4]

New courses, new horses

While the average age of newly appointed directors to Fortune 500 boards has remained flat (at around 57 years old), we have seen signs of an uptick in the appointment of directors under age 40. We will "watch this space" to see if that gradually affects the average age of directors.[5]

Whatever a board member's age, boards are seeking directors with new kinds of functional experience. For example, demand is currently high for those experienced in risk and regulatory issues, supply chain, human resources and talent development, and marketing — all roles that should open doors to a more diverse group of younger candidates.

The pool of available talent is also being expanded by the increasing willingness of companies to allow high-potential executives to sit on the boards of other organizations (while in some cases limiting them to just one outside board). This represents a win–win situation: the new directors (who tend to be younger) offer fresh insights while gaining experience with a different company, its challenges, and its team dynamics.

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4 See Fergus Kiel, *Leaders on Reimagining Boards for a New Era*, www.heidrick.com, December 9, 2014.

5 For more, see Bonnie Gwin, *Trends in board composition over the past five years*, www.heidrick.com, October 7, 2014.

Conclusion

Refreshing a board is not an easy task, and there is little consensus on how to get there. Tenure limits, age limits, and the use of board assessments are all viable tools to assist boards in planning succession and rejuvenating themselves. The key, however, is to ensure a timely source of fresh perspectives that matches the company's long-term strategic challenges. ■

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CEO & Board Practice

The Heidrick & Struggles' CEO & Board Practice has been built on our ability to execute top-level assignments and counsel CEOs and board members on the complex issues directly affecting their businesses.

We pride ourselves on being our clients' most trusted advisor, and offer an integrated suite of services to help manage these challenges and their leadership assets. This ranges from the acquisition of talent through executive search to providing counsel in areas that include succession planning, executive and board assessment, and board effectiveness reviews.

Our Chief Executive Officer and Board Practice leverages our most accomplished search and leadership consulting professionals globally who understand the ever-transforming nature of leadership. This expertise, combined with in depth industry, sector and regional knowledge, differentiated research capabilities and intellectual capital, enables us to provide sound global coverage for our clients.

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