Caveat Praesidem
Chairmen Beware

The key question of how best to appoint a new chair to a board of directors is being made more complex by the new Governance Code and recent interpretations. According to Section 3: Composition, Succession and Evaluation, a new chair should not remain beyond nine years from the date of his or her first appointment to the Board. This creates a whole series of practical considerations.

While there are provisions for extending this timeframe, they are only really intended to allow additional time for effective succession when necessary, and even then should really only apply in cases where the chair was an existing non-executive director on appointment and will therefore have a naturally shortened maximum term.

What are the issues that arise from short tenures for chairs?

We all know that an effective chair's role is not an easy one, balancing as they do the needs of strong stakeholders and building important relationships. As a result, having a chair in place for a period of only five or six years may well be detrimental to the stability and orderly management of a board.

Structure, Culture and Power Dynamics

Structurally, a short duration tenure would mean that a high percentage of chairs would only be able to facilitate limited change in Board composition and are likely to be outlived, regularly, by their chief executives (particularly if the CEO is successful). Crucially, this can create a power asymmetry between the executive and the board – particularly if the CEO is strong willed — eventually weakening a board's ability to effectively exercise oversight.

Creating the right board culture may also be impacted. If on average NEDs serve seven to nine years, and there are five to six on a typical board, it's possible that a new chair will only have to replace two to three directors over their tenure. Perhaps that's for the best, to avoid accusations of cronyism etc. but that's hardly an issue with modern best practice searches and broader investor consultation, is it?

Timing Mismatches and Succession

There are also implications for a chair's effectiveness. Succession planning processes often take twelve months or more. This means a chair who has only just gotten "their feet under the table" may already be looking over their shoulder. For example, British Land recently announced that its current chair, having served six years in role, will be succeeded by an existing non-executive director who has already served since 2014. As a result, the new chair's implied tenure of 5 years creates an interesting dilemma for the chief executive.

Theoretically, having already served 10 years and now in his late-50s, how soon does the British Land CEO move on before 'who goes first' becomes an issue? In this case, there is already a risk that the market will focus on succession in the next few years, making him prematurely a lame duck in the eyes of key stakeholders. It is easy to see how for many boards having short tenure chairs may create unintended consequences. Understanding these potential consequences could start influencing the appointment process and potentially lead a nomination committee to disqualify otherwise highly qualified candidates due to restraints on tenure length.

Having a chair with a sufficiently long tenure to ensure that they are responsible for key aspects of governance and succession planning, is arguably more important than a "one size fits all" dictum that limits the ability of internal NED appointments to provide a proper balance of empowerment and stewardship between the Board and the executive.

What are the implications for selecting a new chair?

Including time already served on a board in the chair's tenure limit increases the likelihood that most new chair appointments will be sought from outside existing boardrooms. It should not be assumed that this is always a good thing. Bringing in new chairs on a regular basis can run the risk of significant board change and disruption. It also limits their influence potentially on culture and best practice – how can they argue with established practice and deeper corporate memories? As a result, their roles may be increasingly reduced to that of a master-of-ceremony rather than business leader/mentor and counsel.

Experience also matters, and will likely be a prima facie requirement. The pool of potential candidates will already be small, particularly given restrictions (rightly) on how many chair responsibilities an individual can hold. Best practice observes that most committee chairs should serve on their committees before appointment, or as a minimum have relevant experience of their role as chair. Ideally, most chairs should have some experience of their fellow directors, board processes and company behaviours on appointment. Therefore joining for six or twelve months to ensure an effective handover is already eating in to their nine year term limit. It also creates additional considerations in how to handle the market communication.

Finding external succession may well, from time to time, be advisable, but it comes with considerable risks, and it may not always be in the best interests of a company to eliminate most of the existing NEDs as candidates because they have already served more than 3 years on the board. Indeed, in a well run board, the best and strongest candidates for the role of chair may well be already be part of the team, well aware of the challenges and with clear views on how to facilitate change.

What should companies and Boards be doing if this is inevitable?

All in all, we are where we are. The new code is in place and companies, by and large, will follow it to the letter to avoid unnecessary explanations and potential criticism.

Nomination committees need to be free to appoint the right people to the key jobs – whether they're already on the Board or not, and they have that right under the new rules. But the implications are complex. What this calls for is insightful counsel to help chairs and committee chairs to plan their agenda, and manage communication with investors. Much of that can come from in-house team members, but various aspects would benefit from an experienced external perspective, particularly when considering how to go about building investor support. Many of these issues can be aided by a measured degree of proactive engagement; the purpose, to explore investor views and bring them back into the board room early enough to make a difference and broad enough not to set hares running. Investors welcome the engagement. The challenge for incumbent chairs and NEDs is to make that engagement valuable to the company by providing insights that help them deliver effective stewardship. Good engagement can also increase optionality and support from investors, which in turn can provide insurance when the best plans fall foul of the strict letter of the code.

Having early warning of key issues can help ensure companies steer a smooth path through the increasingly challenging corporate governance landscape. It's important Boards get good counsel on investor engagement; planning out the key issues, helping with proactive, active-listening conversations and supporting that with effective feedback.

Contacts

Michael Henson
Partner
T: + 44 (0) 7551 720441
E: michael.henson@staterallp.com

John Dawson
Partner
T:+ 44 (0) 7810 831944
E: john.dawson@staterallp.com

Statera Partners LLP | 84 Ecclestone Square | SW1V 1LP

www.staterallp.com