

Compensation, Succession & Evaluation

November 2016
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Summary of Key Discussion Points

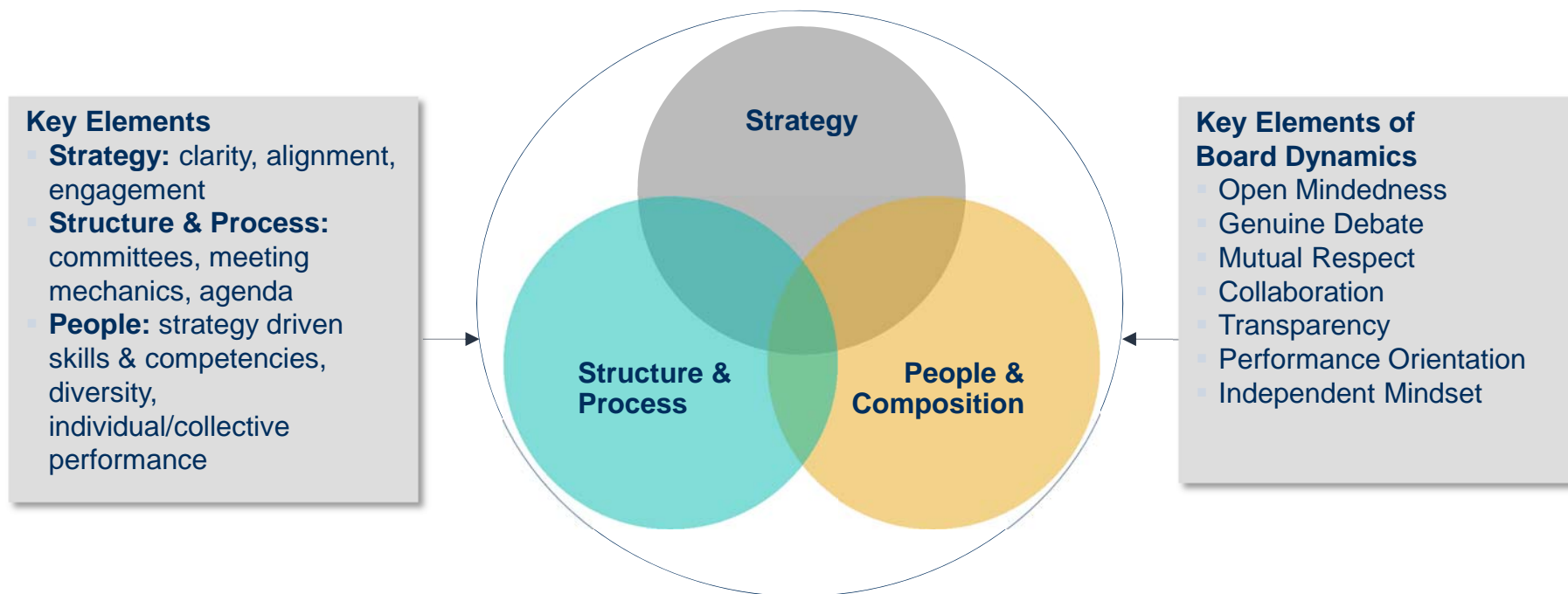
Investors have increased expectations of Board. What have we found out?

- ***Investors want to better understand how (the processes) boards evaluated themselves.***
Investors are specially concerned in better understanding how boards evaluated and improve their own effectiveness. Many see a robust Evaluation process as a good indicator of strong corporate Governance.
- ***CEO Succession planning should be one of the board's top priorities***
Investors want insights in the CEO succession process and some want insights into broader executive succession planning. Investors view this as a risk factor with strong long term and emergency succession planning processes as important risk mitigation responsibilities of the board.
- ***Board skills matrices are useful in helping investors understand the rationale for board composition.***
Several investors cite detailed board skills matrices as a helpful tool to understand composition rationale. Several pension fund managers have already petitioned regulators , SEC in the US for example, to make this type of disclosure mandatory.
- ***Direct Engagement with boards is about proactive (not reactive) relationship building.***
Investors assess the willingness of boards to engage with Shareholders as a signal of board effectiveness and a strong board culture. Investors want boards to be open to building a relationship that allows for appropriate dialogue with the right pace and timing.
- ***Investors want to better understand how compensation at the board and high-senior levels are determined.***
Compensation Management is one of the attributes of the Board and General Board and the parameters over which compensation establishment relies should be transparent and effectively mirror the size and scope of the business, as well as its approach to retain talent and reward best-in-house executives based on pre-determined goals to be achieved.

1.Board

Elements of a High-Performing Board

Elements of a High-Performing Board Culture



Board culture is the sum total of “how we work and how we do things”

Culture = Strategy + Structure + Processes + People

Defining Elements of an Effective Board

Focus Areas	The <i>Effective</i> Board
Strategy	<ul style="list-style-type: none"> Has a clear common vision for company and provides strategic insights that leads to value creation Knows the business very well and can challenge management on its assumptions, strategic plans and utilizes risk management as important oversight tool Understands competitive threats, industry trends, internal and external risks and anticipates disruptive issues and technologies
Structure & Process	<ul style="list-style-type: none"> Has a process that looks at how it can continually improve, add greater value and enhances governance Has an agenda setting process that is focused on critical issues, but is flexible to include emerging issues Has strong mechanics for the board and committees – preparation, document distribution, minutes, etc
People & Composition	<ul style="list-style-type: none"> Is composed of a clear majority of independent directors that have the right mix of backgrounds, skills and behaviors based on the company's strategy Periodically assesses directors against the strategy driven skills and their contributions to refresh the board Engages with executive talent and high potential talent regularly; Semi-annually reviews executive talent and high potentials as part of a thoughtful succession planning process
Culture	<ul style="list-style-type: none"> Has a constructive culture with supporting leadership behaviors which are exhibited by each board member Has a culture that promotes trust, respect, candid conversation /debate and camaraderie Has a relationship between board and management based on mutual respect and constructive dialogue Seeks new ideas and demonstrates innovative thinking Has a collective desire for a diversity of perspectives, backgrounds and experiences

Key Questions for Boards Around Performance and Culture

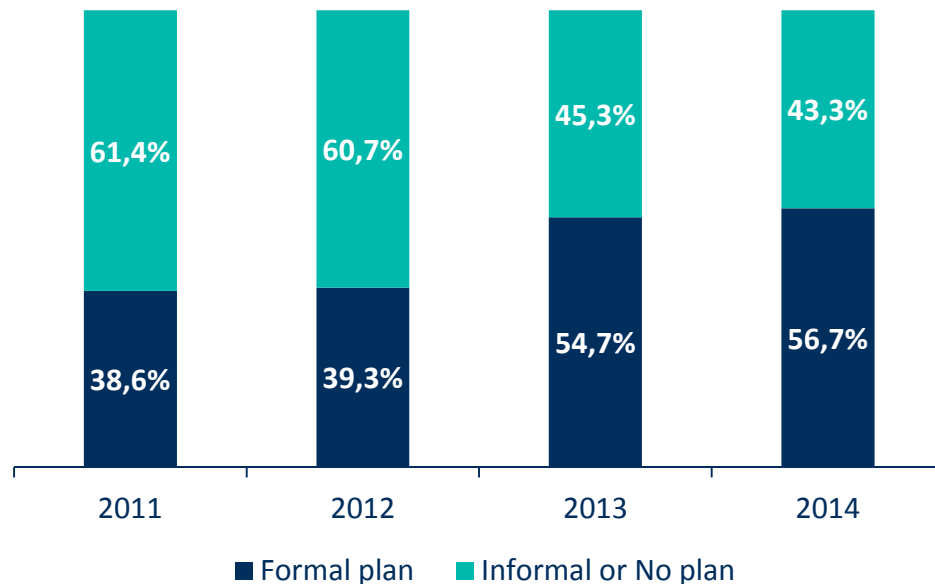
Focus Areas	Sample Questions
Strategy	<ul style="list-style-type: none"> ▪ Are we aligned around our strategy? ▪ Does the Board have a strong understanding of competitive threats and strategic risks? ▪ Can the Board appropriately challenge management on their assumptions and plans?
Structure & Process	<ul style="list-style-type: none"> ▪ Does organizational structure – and do our procedures – support our strategy? ▪ Do we regularly improve the way we do things? ▪ Do the mechanics of the Board – preparation, distribution of documents, minutes, meetings with management, strategy review days, etc. – support its role and responsibilities? ▪ Is there a succession plan in place for each director and each key committee role?
People & Composition	<ul style="list-style-type: none"> ▪ Does the overall composition of our Board support our strategy? ▪ Do non-executive Board members as a group have the right balance of backgrounds, experience and behavioral competencies to enable them to provide insights to management? ▪ Do we regularly assess our individual and team performance ?
Culture	<ul style="list-style-type: none"> ▪ What is the Board culture and what would the Board like it to be? ▪ Does the Board's culture help us to make better decisions? ▪ Is there trust amongst all members of the Board?

2. CEO

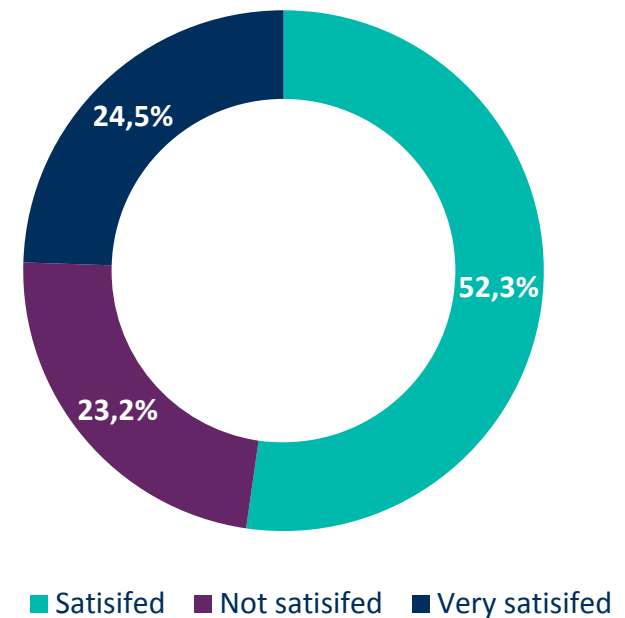
The current state of CEO succession planning

Although companies are increasingly formalizing succession plans, more than 40% still do not have a plan or approach more informally, significantly impacting satisfaction with preparedness for the next CEO.

Percentage of Boards formalizing CEO succession plans¹



Director satisfaction with CEO succession plans
Only 1 in 4 are very satisfied with plans, though boards with more formal plans tend to be more satisfied.



Source: NACD 2014-15 Public Company Governance Survey, RRA analysis

Common problems with succession plans

Problem #1: “Off the Record” approach

Succession is discussed, but often in more casual settings or in a one-off manner with a few directors (rather than the entire board)



13%
of “plans” are never written down

50%
would not be able to name a successor if the incumbent CEO was incapacitated

Problem #2: The “Inch Deep” plan

Many plans stop after identifying the emergency fill-in or only focus on ready-now candidates. This leaves the board blind to bench strength and the organization vulnerable with few options should any ready-now leaders leave.



39%
of boards have “zero” viable internal candidates

61%
Of those not satisfied with plans have no long term planning included

Problem #3: The “Point in Time” plan

Static plans create vulnerability, as internal and external labor market shifts more frequently than the plan is updated..91



Less than 50%
of board directors have a strong understanding of internal candidate capabilities

2 hours
Average board time per year spent on succession planning

Source: 2014 – 2015 NACD Public Company Governance Survey; 2014 Report on Senior Executive Succession Planning and Talent Development, rock Center for Corporate Governance, RRA analysis

Examples of poor succession planning

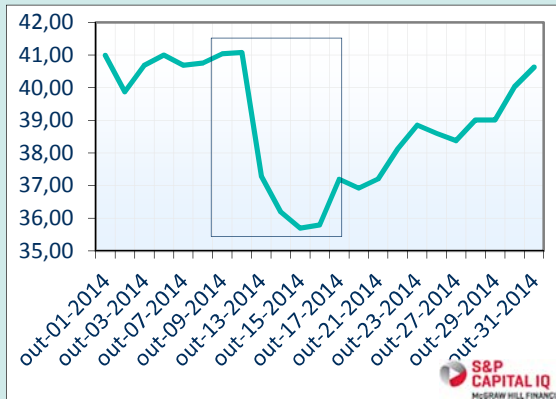
Sanofi

Sanofi abruptly removed Christopher Viehbacher as CEO on October 29, 2014, just two days after issuing a public statement following a board meeting which said the board had “no agenda item regarding the succession of Chris Viehbacher.” The day of the ouster, the Chairman announced he would step in as interim CEO, and that the board was “forced” to make a decision due to “leaks organized in the press.” The crisis wiped out \$22 billion in investor money over a 3-day period.



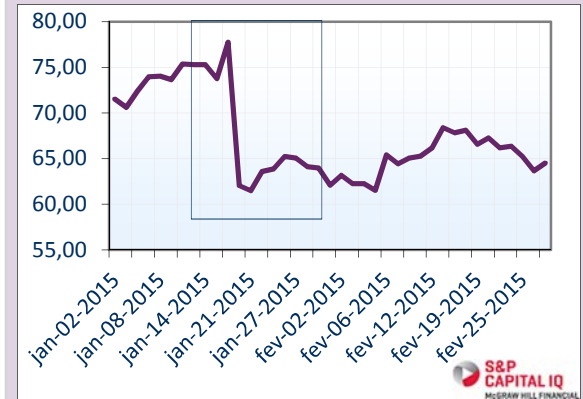
Luxxotica

Luxxotica CEO Andrea Guerra stepped down in the fall of 2014 after disagreements with the founder and chairman. The initial replacement resigned after just a few weeks in seat, when the founder decided he would be one of two co-CEO's with another as-yet-unnamed person. The clear confusion caused a significant drop in the share price.



Outerwall

J. Scott Di Valerio unexpectedly resigned from Outerwall on January 18, 2015, with a board member stepped in as interim CEO while searching for a long-term replacement. The statement from board Chairman Nelson Chan hints Di Valerio was forced out, saying the board “believes that now is the right time for a leadership change.” The owner of Redbox DVD rental kiosks went through a similar unexpected transition just two years ago when then CEO Paul Davis, left.



□ = point of announced transition

Source: S&P Capital IQ, Bloomberg.com, Fortune.com, FT.com, deadline.com, RRA analysis

Principles of Best Practice long-term CEO succession planning

- Address CEO succession planning and transition issues head-on, even if encountering resistance or discomfort

- Move strong internal talent to developmental roles and eliminate “blockers.”

- Understand strengths, weaknesses, experience, leadership capacity, and character. Plan candidate interviews carefully

- Ensure both internal and external candidates feel they are involved in a transparent, fair process. The process itself should operate as a retention tool



- Begin transition planning several months in advance and continue for several months into the new CEO's tenure

- Keep transition periods short – 6 months maximum of overlap between the outgoing CEO and incoming CEO

- Monitor hidden emotions and tensions between the CEO, internal candidates, and/or various board members

- Adhere to a disciplined process, but be prepared to move fast – and elevate an incoming CEO sooner than planned - if circumstances merit quick action

Source: RRA analysis

Examples of successful CEO succession planning

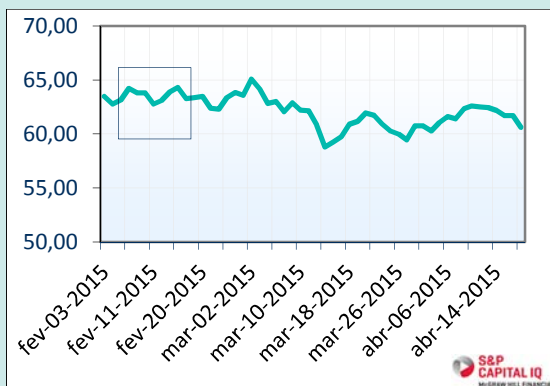
Wal-Mart

- In 2013 Wal-Mart named company veteran Douglas McMillon its next CEO, to succeed then CEO Michael Duke. McMillon has worked directly under Sam Walton, the founder, and has been groomed for the role for some time
- Wal-Mart has a long history of grooming leaders from within and said it began planning for Mr. Duke's succession years earlier. Among the favored candidates were Mr. McMillon and Mr. Simon
- Shares of Wal-Mart inched up 0.8% after the succession was announced to \$80.43. They were near their highest price within 12 months



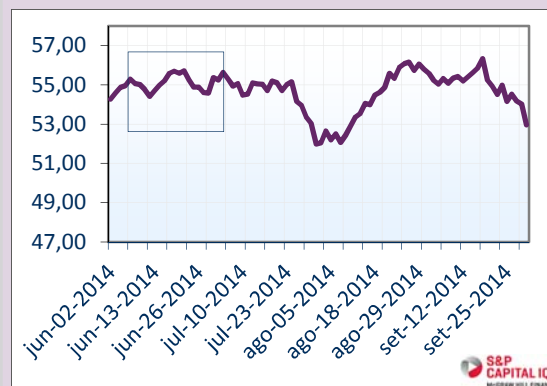
Harley-Davidson

- In February 2015, Harley-Davidson has announced that CEO Keith Wandell will step down on May 1st and will be replaced by Matthew Levatich, the current President and COO
- Wandell, who joined Harley-Davidson as an external appointment in 2009, said upon exiting that "the most important achievement [of his tenure] has been the development of great leaders at all levels of the organization," enabling the company to groom an internal successor
- Harley's revenue has been on the rise. Its stock price has risen from about \$17 per share in May of 2009 to \$63.54 per share earlier in 2015. That 274% increase outpaced the S&P 500, which climbed 123% over the same time period



AIG

- When Robert H. Benmosche, AIG CEO, was diagnosed with cancer, the company board immediately and proactively set in motion a succession planning process. As a first step, the board signalled to the market that, in the event of an emergency, AIG Chairman, Robert S. Miller, would act as the Interim CEO
- Peter Hancock, who dealt with finance, risk and investments, was put in-charge of its property-casualty business, a key position running operations, to develop him as a potential candidate for CEO. He was later named CEO of the company and took over from Benmosche after his departure



□ = point of announced transition

Source: WSJ.com; Bizjournals.com; <http://www.prnewswire.com>; uk.reuters.com; RRA analysis

Common Mistakes in CEO and Executive Succession Planning

- ✗ The **same names** show up in succession plans year after year and outdated candidates are not removed.
- ✗ Succession choices **lack objectivity** and are influenced too heavily by personal relationships.
- ✗ There is **insufficient mobility** across geographic or businesses and well rounded leaders are not developed.
- ✗ Absence of **collectively agreed-upon criteria** for ideal candidate profile, making candidate evaluation difficult.
- ✗ Succession **process is opaque** and the criteria is not clear or prioritized.
- ✗ Candidates are assessed solely in the **context of their current role**, not their potential fit with the future requirements of a specific role or the evolving requirements.
- ✗ The assessment **process is done “to” the internal candidates** and creates a competitive or unhealthy environment rather than a process focused on their development and growth.
- ✗ **Retention risk is increased** because leaders are not informed whether/where they fit in future succession plans. In the absence of feedback and insight about how they are viewed, many executives assume the worst or they make unrealistic assumptions about what is possible for them to achieve.
- ✗ Insufficient thought is given to the **individual’s style or cultural fit** with the business situation or team, increasing the risk that they will disappoint or derail.
- ✗ There is **no formal onboarding process** and they are not set up for success.

Key roles in the CEO succession process

Key stakeholders each play an important role in the process. Role clarity helps mitigate the inherent risks related to CEO succession and search

Board of Directors

- Owns and is ultimately responsible for the CEO succession process and outcome. Reviews the process and holds the CEO accountable for developing internal candidates
- Selects CEO successor and works with the incumbent CEO to ensure successful transition
- Instills confidence in a successful CEO appointment and transition. Monitors the development of a robust internal leadership pipeline, a critical sign of good governance

CEO

- Provides the Board with informed perspective on the readiness of the internal candidate(s).
- Directs the involvement of SVP HR to collaborate in developing a rigorous assessment process.
- Offers the Board continuing feedback on internal candidates and progress against development plans.
- Has critical input into the process with independence of thought and judgment.

Human Resources

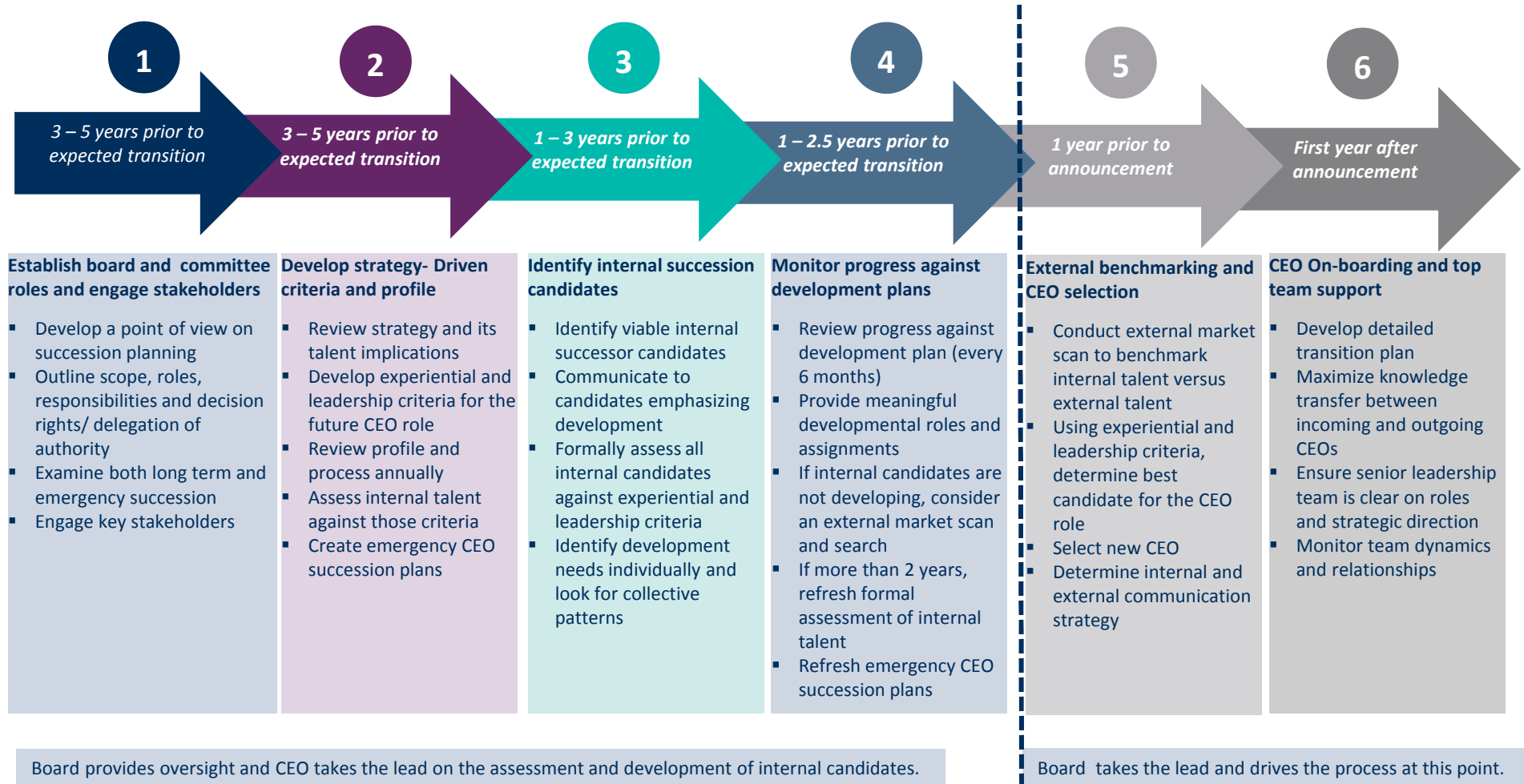
- Works closely with outside experts to share information and provide input on an assessment process to the Board, the CEO, and any internal candidates.
- Advises CEO on any issues that arise around the CEO succession process.

Outside Experts

- Advise the Board on best practices and fiduciary responsibilities throughout the CEO succession process.
- Provide advice on the overall architecture of a long term process with key input and decision points.
- Partner with Board and CEO to develop experiential and leadership criteria based on the business strategy.
- Assess any internal candidates against defined criteria; calibrate internal talent against external talent market.

Source: RRA analysis

Best Practice long-term CEO succession planning - process



Source: RRA analysis

3. Executive Officers

Outcomes of Succession Planning

Research demonstrates that succession planning is associated with a number of positive outcomes for organizations, and is seen to be a hedge against risk in many cases...

Sample
HR executives
from 968 publicly
traded U.S. firms

High-performance work practices featuring succession planning were associated with **employee retention, productivity, and organizational financial performance.** (Academy of Management Journal)

Sample
2500+ US- and
Japanese-owned
firms

The quality (**attention to design, commitment of top-level management, credibility of planning staff, and effective resource allocation**) of succession planning predicts HR performance outcomes. (International Journal of Manpower)

Sample
4498 Succession
Events

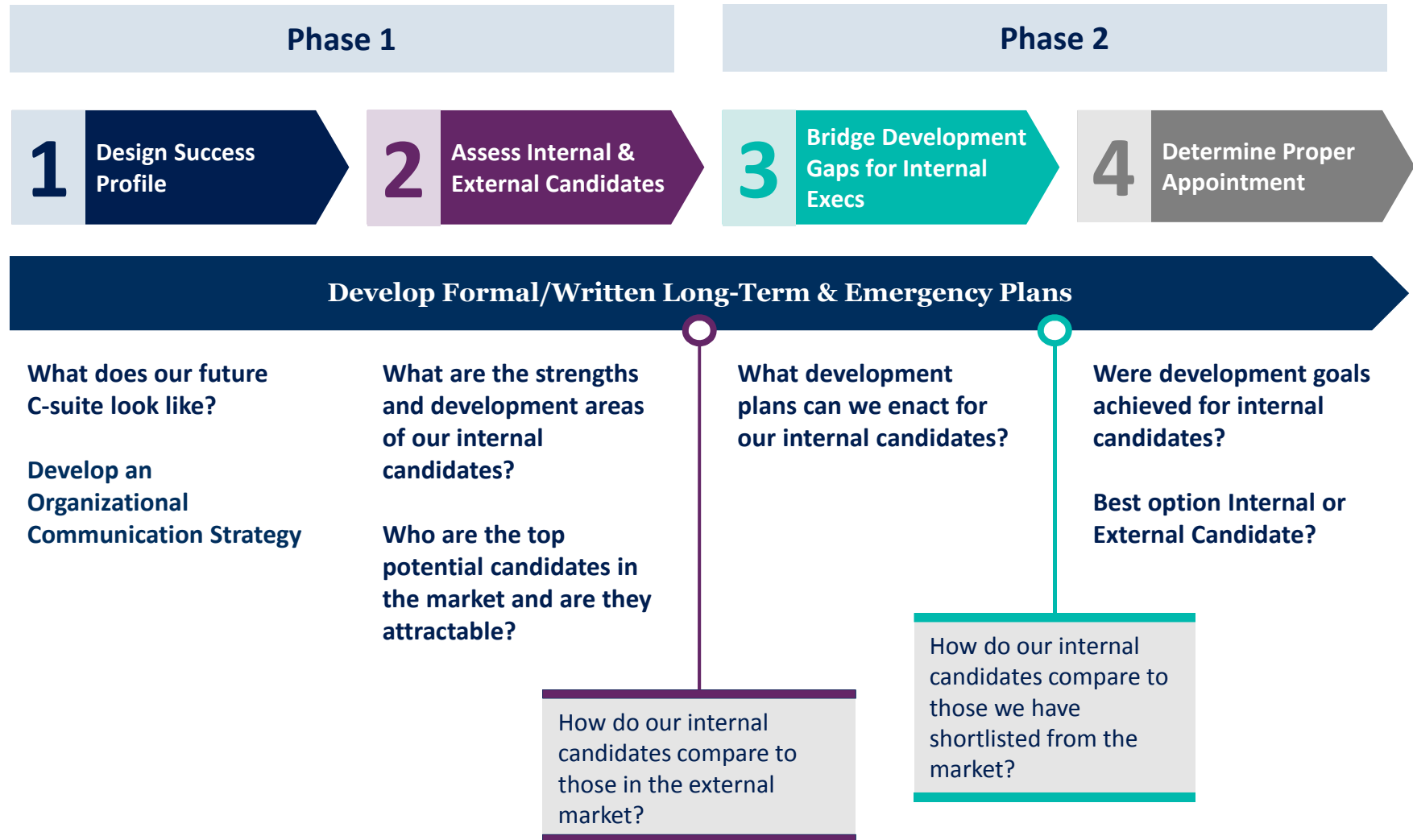
Companies in the lowest quartile of performance had poor succession practices relative to other companies, and more often forced out current CEOs (Succession Planning and Financial Performance, PWC)

Sample
56 large and mid-sized US
companies

Companies in the top quintile of talent-management practices, such as succession planning, had a **22% higher return to shareholders** than their respective industry averages. (McKinsey Quarterly)



Overview of succession planning process



1. Design the success profile: communication strategy

Developing an organizational communication strategy is critical to the strong foundation for the assessment project's success.

- RRA will begin by interviewing the CEO, key HR leaders, and select Board Members to ensure we have a complete understanding of the vision, mission, strategy, and culture of your organization going forward.
- We will also ensure alignment on the details of the project including deliverables, timeframe and milestones.
- RRA will then work with your project sponsors to put an organizational communication strategy into place employing our previous experience in working with other clients.
- Communication strategies are critically important to ensure that project participants – as well as others who may be touched by the succession project – have an appropriate and positive perspective on the project's objectives, tools and processes.

Consulting to the Board

- RRA also uses our meetings with the Board to educate them on succession planning as well as the roles of Succession, Compensation and/or Nominating Committees in the succession planning process.
- The retention of key talent throughout the process is a key component – and a useful metric – of any successful succession plan.
- We will discuss what actions the Board and CEO can take to increase the chances of talent retention throughout the process.



1. Design the success profile: developing executive competencies

An additional purpose of our interviews with the Board, HR leaders, and the CEO will be to ensure we have a clear understanding of the organization's vision, mission, strategy, and culture to create success profiles that clearly define the requirements for each role.

- If the organization desires detailed job specifications for each role in addition to your company's Executive Competency Model created for the purposes of succession planning, we can easily accommodate this request. This can be done for certain roles or for each position.

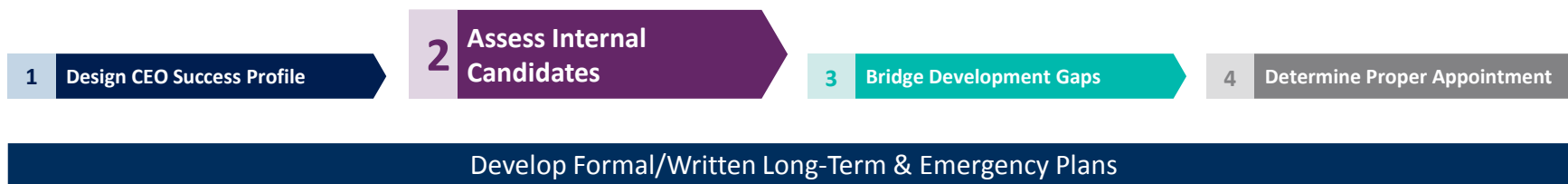
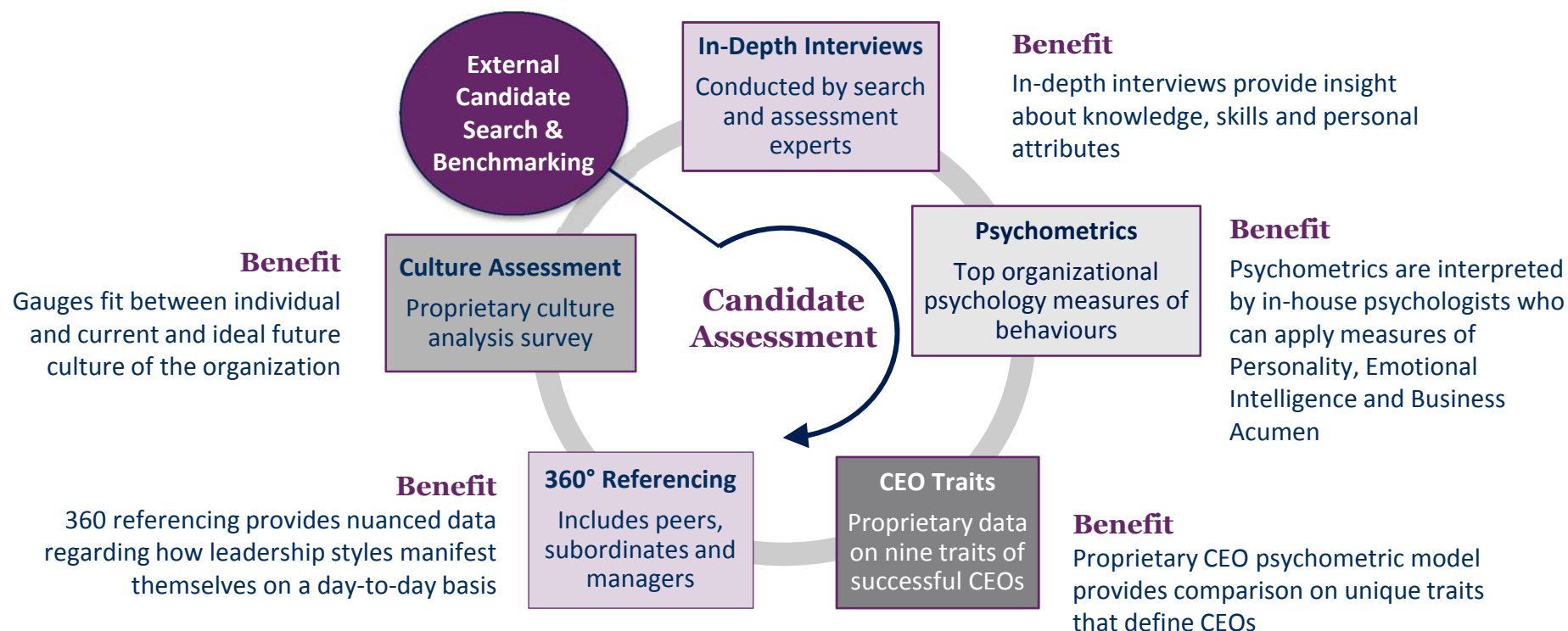
We recommend the following approach to establishing specific success factors:

- **Optional: Create job specifications for each position**
 - A detailed job specification will be created for each of the seven positions to use in evaluating succession "candidates." We typically recommend this is done for at least the CEO role.
- **Create an COMPANY Executive Competency Model**
 - A tailored COMPANY Executive Competency Model will be created with the future in mind.
 - This will be used to evaluate the executives against their current roles in anticipation of the organization's continued growth and complexity.
 - In addition to interviews with the Board, HR leaders, and the CEO, RRA will speak with other key leaders to help gather the data to create the customized *Executive Competency Model*.
- An *Executive Competency Model* is a selection of competencies or characteristics that all COMPANY executives will need to possess regardless of function. These may include skills like *Delegating Responsibilities*, *Maintaining a Strategic Perspective*, or *Holding People Accountable*.
- These competencies are further defined and customized for your organization's unique growth strategy, market niche, and organizational culture.
- Each individual will also be assessed against technical requirements and background/ experience (e.g., expected financial background for CFOs) for their individual roles or functions.



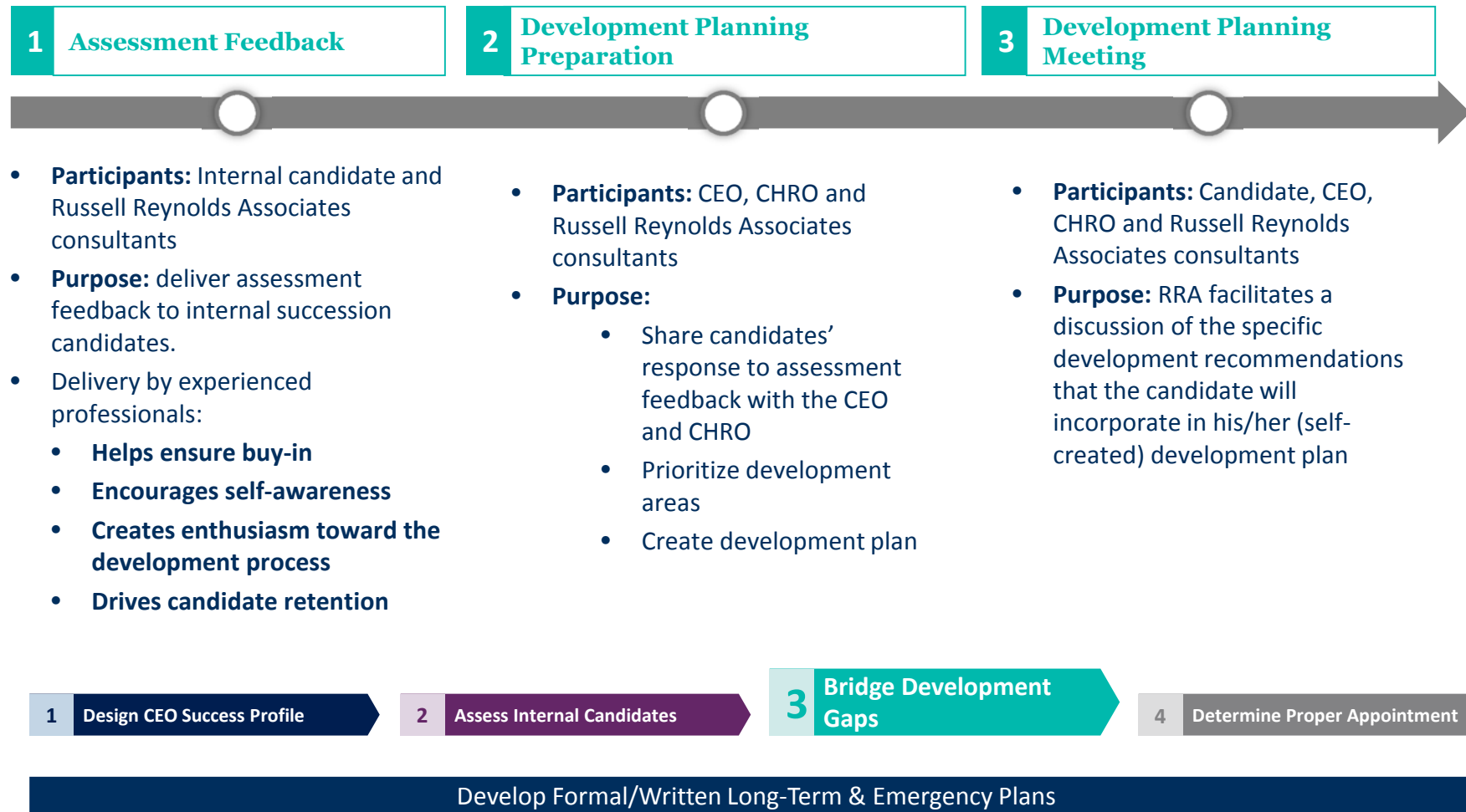
2. Assess candidates: overview

An assessment of internal and external candidates based on the CEO success profile.



3. Bridge development gaps: internal candidates

Assessment and planning engages senior leaders in their own development.



4. Determine proper appointment: provide feedback to executives

RRA provides face-to-face individual feedback that includes a written report and an in-depth developmental discussion. It is not unusual for executives to tell us that our feedback is the most thoughtful, balanced and useful developmental information they have received during the course of their careers.



Development Options	
Facilitate Development Alignment	RRA will facilitate an alignment meeting between the executive, his or her manager and HR. Agreement on the key developmental priorities and the plan for addressing them is the focus of the meeting.
Craft a Development Plan	RRA will work with the executive to craft a complete development plan that includes concrete actions and activities.
Coach the Executive	RRA can support the development plan with executive coaching and counsel.
Audit Development Progress	RRA can conduct a development audit that answers the question <i>“What development progress has taken place - and what is left to do.”</i>

4. Compensation Management

How PE Funds are Managing Compensation at the Portfolio Companies



Increase In Management Equity Pool

Management equity pool reserves have increased to 12% of fully diluted shares (up from 10% in earlier studies), at the median.



Cash Compensation Levels

Cash compensation (salary plus annual bonus opportunity) for executives at sponsor-backed companies is generally aligned with market competitive pay levels for public company executives.



Award Vesting And Performance Goals

Sponsors continue to tie award vesting to performance-based conditions.



Plan Participation

Participation is generally limited to the two-to-three most layers of senior management



Driving Performance: Award Vehicles

Stock options remain the most prevalent form of equity compensation used by financial sponsors.

Source: PwC's 2016 US Private Equity Portfolio Company Management Compensation Survey.

Q&A