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The CEO and the nomination committee

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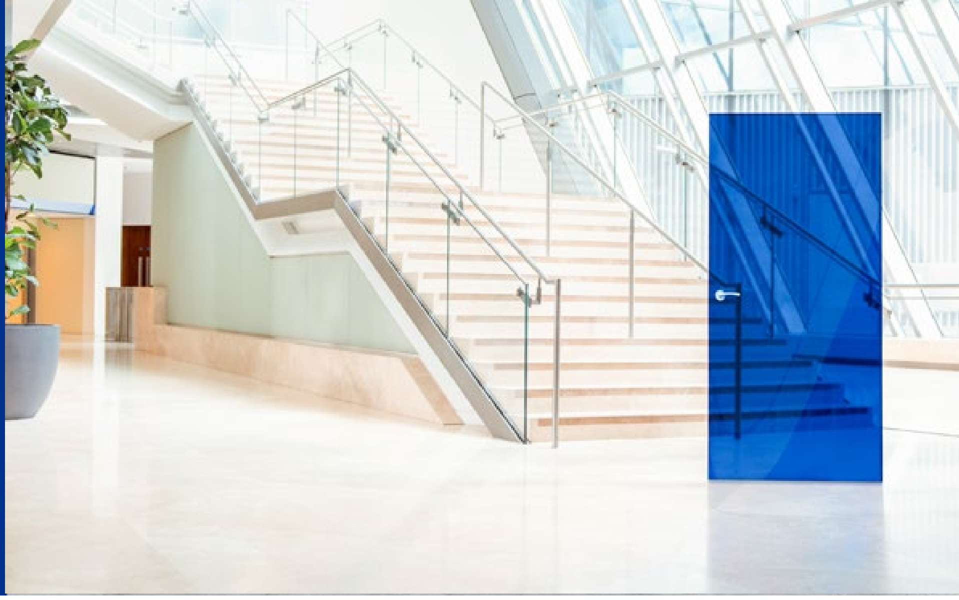

Does having the CEO on the nomination committee help or hinder value creation?

In this article, Jenny Simnett, doctoral researcher at Henley Business School investigating the strategic value from nomination committees in UK listed companies, weighs up the advantages and disadvantages of the CEO on the nomination committee, offering guidance on how companies can realise optimum value from their inclusion.

The response to a recent LinkedIn poll was overwhelming with unequivocal and polarised views. Of 92 votes, a 42 percent claimed that the nomination committee should be purely for outside non-executive directors with 46 percent voting that the CEO should attend as required or depending on the agenda. The remaining 12 percent opted for ‘it depends on the business’. This almost equal split in response to the CEO sitting on nomination committee or not indicates a divergence of thinking which is not helped by corporate governance codes. Despite this majority view, albeit in an unscientific online poll, there are clear downsides to the CEO being excluded from the nomination committee and non-executive directors making isolated decisions without CEO input.

Anglo-American Governance

The role of the CEO on board committees is variable across the different Anglo-American systems. The US governance system has long had a tradition of combining the CEO and board chair roles and this convention still persists today. However, the Sarbanes-Oxley legislation in the US discourages CEO membership of the nomination committee. Also, CEO participation is opposed by regulators in Australia. The 2018 UK Corporate Governance Code has a lighter touch and stipulates no restriction to the CEO being a member of the nomination committee provided a majority of its members are independent non-executive directors.

Value Creation

One clear advantage to the CEO being included in nomination committee meetings is that he/she is the senior executive who knows the business best and is arguably the executive closest to the corporate strategy as they are accountable for implementing it.

With the CEO sitting on nomination committee, the independent non-executive directors have a further opportunity to challenge and advise the CEO on the key activities of the nomination committee, namely board composition, director recruitment, succession, diversity, induction, performance development and possibly also board evaluation. For example, including the CEO in director recruitment campaigns can allow better coordination, more consensus on skills sought and improved communication between the executive team and the non-executive directors. The CEO’s views on executive director selection are critical to ensuring they remain engaged in the process and the outcome as they build a high-performing executive team.

Also, there is an argument to say that the presence of the CEO on nomination committee can act as a catalyst for bringing the non-executive directors closer to the business and its stakeholders. The CEO’s informed input can lead to faster execution of actions and can empower the nomination committee in terms of realising strategic value to the board. The CEO also has executive accountability for the people and culture orientation of the organisation so this is well-aligned with the responsibilities of the nomination committee.

From the perspective of the CEO, their presence on nomination committees can be a safe space for them to discuss the strengths and development areas of the executive directors and their succession. This sounding board is critical as their role can be lonely, despite the chemistry they have with the board chair and the collaborative working relationships with their colleagues.

The nomination committee chair, non-executive directors, the CEO and the board chair all play a role in setting the tone for an effective board culture.

In turn, the CEO can reinforce the corporate culture and values in the business. Therefore, the CEO’s presence on the nomination committee encourages consistency. Exploration and synthesis are possible as part of the more fluid and less prescriptive nature of nomination committees when compared to audit and remuneration committees.

Building board composition for the future sustainability of the business is both strategic and value creating.

Risks

If the CEO is not regularly included in nomination committee meetings, is there a potential risk of an overly theoretical 'blue-sky' discussion amongst the non-executive directors? Would the CEO perhaps provide a grounding presence and insights on business reality. This level of detail and feedback is highly likely to be pertinent and provide the necessary context for productive dialogue.

The influence of the CEO (alongside the Company Secretary) in producing the papers for the nomination committee meetings could unduly (and unintentionally) skew the information flows and what gets reported. The CEO may drive the agenda to some extent, especially if the nomination committee chair is not well versed in people management or strategy. This gatekeeper role of the CEO is mitigated by their personal integrity and drive for transparency but it is open to abuse if the CEO overly influences important outcomes.

If the CEO and the board chair both sit on nomination committee then there is a possible risk of crossover and duplication with board meetings, especially on such topics as diversity and board evaluation. Moreover, if the board chair also chairs the nomination committee as permitted by the 2018 UK Corporate Governance Code, then the quality of the relationship between the board chair and the CEO can impact the debate and recommendations from nomination committee to the board.

There are naturally some areas where the CEO needs to be excluded due to conflicts of interest, perhaps some of the discussion around CEO performance, succession and the recruitment of their successor. However, this can be managed with good forward planning of the agenda and efficient process management in the meetings by the nomination committee chair.

Considerations

The more independent the composition of the nomination committee, the more this committee can constrain any opportunistic or inappropriate CEO behaviour. The nomination committee must be able to monitor and if necessary, mete out discipline, even dismissal of the CEO if there is risk of serious reputational damage or ethical violations. However, this depends on true independence and no conflicts of interest, even via shared social networks with the CEO. This is where the implementation of diversity of all types plays a part in preventing director homogeneity.

Equally, if the CEO rarely attends nomination committees, there needs to be clear and optimal process in place to enable director recruitment and selection to be actioned. The communication channels, whether via the board chair or the nomination committee chair should ideally enable information exchange and feedback from and to the CEO to both elicit their views and ensure there are no surprises when decisions are made.

It is considered invaluable for all non-executive directors to have a regular opportunity to discuss significant issues pertaining to nomination committee. This chance to discuss issues freely without the CEO being present can lead to value creation and should be engineered if it isn't happening - formally or informally.

Future Guidance

The Financial Reporting Council intend to consult on the current UK Code during mid-late 2022. In the light of the issues raised above, it will be interesting to see if and how the presence of the CEO on nomination committee comes under the governance spotlight.

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The KPMG Board Leadership Centre

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