

## Corporate Governance Handbooks

# Guidelines for Succession Planning, Evaluation and Compensation of the Board of Directors and the CEO

# **Guidelines for Succession Planning, Evaluation and Compensation of the Board of Directors and the CEO**

**IBGC** | Instituto Brasileiro de  
Governança Corporativa

**2020**

## ● ● ● ● Brazilian Institute of Corporate Governance (IBGC)

Founded on November 27, 1995, the Brazilian Institute of Corporate Governance (IBGC), a civil organization, is the Brazilian reference and one among the main reference organizations for corporate governance worldwide. Its purpose is to generate and disseminate knowledge on the best corporate governance practices and influence the most diverse agents in its adoption, contributing to the sustainable development of organizations and, consequently, to a better society.

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Production of the translated publication Translators: Cintia Isobata Aquino, Fernanda Vitarelli, Gisela Christiano, Mônica Pimentel de Mello Moreira; Proofreading: Camila Cristina da Silva; Back-office support: William Barros A. de Melo; Graphic design, layout and cover: Kato Editorial; Translation costs: IDB Invest.

International Cataloging Data in Publication (CIP) according ISBD

G946 Guidelines for Succession Planning, Evaluation and Compensation of the Board of Directors and the CEO / organized by Instituto Brasileiro de Governança Corporativa – IBGC ; translated by Cintia Isobata Aquino... [et al.]. – São Paulo, SP : Instituto Brasileiro de Governança Corporativa – IBGC, 2011.

69 p. ; 18cm x 25,5cm. – (Corporate Governance Handbooks Series, 10)

ISBN: 978-65-86366-31-0

1. Corporate Governance. 2. Companies. 3. Board of Directors. 4. Succession. 5. Family Business. I. Aquino, Cintia Isobata. II. Vitarelli, Fernanda. III. Christiano, Gisela. IV. Moreira, Mônica Pimentel de Mello. V. Title. VI. Series.

2020-2750

CDD 658.4  
CDU 658.114

Prepared by Vagner Rodolfo da Silva – CRB-8/9410

Index for systematic catalog

1. Corporate Governance 658.4

2. Corporate Governance 658.114

## ● ● ● ● Credits

This work was developed by the IBGC Human Resources Committee. The creation of this document involved intensive debate and public consultation, from which several contributions and suggestions were obtained.

## ● ● ● ● Acknowledgements

We would like to acknowledge the help of all members of the IBGC HR Committee, who have spared no effort to summarize the current and emerging practices used in Brazil and world-wide regarding succession planning, evaluation and compensation of Boards of Directors and CEOs. We also thank Ram Charan, for drafting the Foreword, and each person who made contributions to the text during the Public Consultation.

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# Foreword by Ram Charan

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In the contemporary knowledge-based economy, the most relevant assets are human capital, education, innovation, technology, and entrepreneurship, rather than properties, natural resources, plants, or equipment.

According to the Organization for Economic Co-operation and Development (OECD), countries such as Finland, the United States and the United Kingdom already invest 10% to 20% more in intangible than in tangible assets; such investment represents 10% to 14% of those countries' GDP.

Many companies manage with diligence and sophistication their tangible and financial assets, but not their human capital, an issue that has been little explored.

We do know, however, that the market value of leading companies such as Apple, P&G, GE, Microsoft, JP Morgan, among others, can be greater than their book value, mostly due to the people that create their brands, manage their operations, make product and service innovations, win competitions, attract and assist clients, and make decisions that affect the companies' results and future value.

These companies and a growing number of others regard people as their most important factor, since they create value and produce results.

From that point of view, I consider these Guidelines for Succession Planning, Evaluation, and Compensation of the Board of Directors and the CEO, organized by the IBGC, unquestionably one of the main references for corporate governance.

These guidelines intend to help Brazilian state-owned or private companies, of any size and from any economic sector, to improve their people management practices, carried out by either the Board of Directors or by the managers.

Talents are at the core of the knowledge-based economy and are the main tools for its development. Therefore, only companies that win the heart and the mind of its workforce will be able to create long and short-term value; only companies that invest in people will have a sustainable performance.

# Presentation

Based on market trends and on the intense interest of the business community, the IBGC invited a team of more than 30 professionals from different fields and specialties to participate in the Human Resources Committee; those professionals engaged in the study of one of the most relevant subjects for good governance: PEOPLE

The Committee, bearing in mind the premises of recognition, development and differentiation, examined which issues are currently strategic for the management of people in the business context and should be addressed in the first place. Thus, after debates, studies and learnings, it decided to focus on the following matters: Succession, Evaluation, and Compensation.

These issues are directly linked to the modern perception of governance and are critical factors for the companies' success, longevity and risk reduction. On the other hand, their intangible nature allows for different opinions and interpretations, what leads to new challenges and opportunities for researchers and specialists on the subject.

We hope these *Guidelines for Succession Planning, Evaluation, and Compensation of the Board of Directors and the CEO* will encourage continuous improvement to the upper management practices and to the relationship among people, companies and the society.

# Part I:

# Succession

# Planning

## 1. Relevance

### ● ● ● ● Introduction

The consistent development of technology and the evolution of business models have created increasingly complex global markets. In this new context companies of all sizes and from any sector are expanding their operations through organic processes, mergers or acquisitions, IPOs, strategic alliances, entrance into new markets, or any combination of these factors.

The expansion of the global economy, the markets and the competition, and also the imposition of new regulatory requirements, have deeply transformed the professional profile sought by companies, while also revealing a lack of skilled human resources to be placed in new leadership positions. Although in the past companies used to give more importance to tangible assets, such as capital, property, natural resources, machines and equipment, nowadays they increasingly depend on intangible assets, which comprise intellectual capital, innovation capacity, management quality and trademarks, among others. Notwithstanding, few corporations have internal structured programs for preparing the future leader that will ensure business longevity. A survey conducted to identify issues of interest to the Board of Directors pointed out that the directors would like to give more attention to the development of talents and skills within the company.

The Board of Directors, which is the main governing body, has the goal of protecting and adding value to the companies' asset and should organize, conduct, and supervise the process of succession of the CEO<sup>1</sup>, of other key executives, and of its directors. Every company should have a succession

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1. CEO – Chief Executive Officer.

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planning, regardless of its corporate structure or of its being a publicly or privately held company. The company's People Committee (or Human Resources), where it exists, can assist the Board of Directors in performing such task.

The planning should not be treated as a single event, rather as a continuing process for preparing and guiding the changes in leadership, to ensure the company's sustainability and longevity.

The succession planning, which is a fundamental practice of the modern management, should not be isolated from other aspects. It should be in line with the company's strategic objectives and support the way the company is to evolve to reach its goals related to growth, profitability, and economic, social and environmental responsibility. Succession planning, therefore, involves the identification, evaluation, and development of talents to provide the company's key positions with leadership talents; it also implies permanent supervision to avoid setbacks resulting from unexpected and unplanned succession.

It applies to companies of different sizes and types: family businesses, private or listed companies, government-controlled private companies. Therefore, succession planning does more than just ensure a coordinated transition in the company's highest position. Above all, it prepares the most qualified people for the company's key functions, what includes being a member of the Board of Directors.

## ● ● ● ● 1.2 Impacts on the Company

The absence of a succession planning destroys a company's value and risks its credibility in the market and in the eyes of the interested parties. In addition, shareholders and the Board of Directors may be considered negligent in performing their functions and responsibilities. Companies are made of people. In this context, investors, employees, clients and partners are concerned with the transparency as to who runs the business, how and according to which philosophy.

Succession planning is, therefore, important in the sense that it evidences the stakeholders' intent regarding their business, considering the expectations both inside and outside the company. It also guides the development of critical capacities, defines the metrics to measure the managers' performance, detects shortcomings, identifies possible successors, and contributes to overcome fiefdoms that impair the management of any company.

A comprehensive, continuous, and objective succession planning process, apart from being a good corporate governance practice, shows to the stakeholders the relevance of business continuity for the company. The company, through that process, reveals coherence between its vision of the future and business action and conveys to investors and employees a clear message regarding the cycle of leadership continuity.

One of the risks of this process is the possibility of cycle discontinuity, what would lead the company to recruit executives in the market. When the succession planning is flawed or leadership is poorly developed, the result is a shortage of suitable internal applicants and greater dependence on external resources. The company's professionals are more aware of its ideology and values. Hiring managers in the market, thus, brings an additional challenge related with alignment with the company's culture.

When any of the main managers, including the CEO, leaves the company in an unplanned manner, there is some degree of impact on the company's strategy, operations, profit generation and distribution capacity or motivation. Succession planning ensures the development, retention, and continuous provision of leaders, and maintains the company's values and essential capacities.

## 2. Principles

### ● ● ● ● 2.1 Different Phases of the Company and Partners

Companies' development goes through different phases of evolution. The sector's dynamics and the corporate culture present additional challenges for the leadership. In any way, we will address market practices that should be tailored to the needs of each company.

### ● ● ● ● 2.2 Aligning Profile with Business Strategy

The successor selection criteria for any executive position and for the board should be in line with the corporate strategy, based on the shareholders' interests and expectations.

Such work requires a consensus among the members of the Board of Directors, about which phase the company intends to reach in the short, medium, and long term, regarding entrepreneurial skills, investments, future growth, business diversification, market share, global footprint, profitability goals and strategic alliances, among others.

It is easier to just continue with the work already initiated by a successful CEO that is leaving the company, than to consider a shift in the company's course. However, Boards of Directors that take such action can become hostages of the past, thus substantially limiting their capacity to create future value for the company.

The succession planning process should be considered a part of the company's strategic planning, which should not only address future scenarios and determine strategic options, but also identify the kind of leadership required to face the emerging challenges. The succession planning should be integrated into the company's strategic objectives and determine how the company should evolve to

reach its business goals. It might mean that the type of leadership, skills and behavior required in the future will be different from what is currently required.

## ● ● ● ● 2.3 When to begin the Succession Process?

The inability to select a suitable CEO and key executives for the company may bring competitive disadvantage that can last for years. Thus, the recruiting of executives should begin once the selection criteria are established. Internal recruiting is, for the most part, the preferred source of workforce, since it allows the Board of Directors to understand more deeply the candidates' potential, skills and personality traits; the process should begin as early as possible and the planning should be periodically revised. During the succession process the Board of Directors will have time to identify potential successors, offer them the opportunity for development and observe their performance. Close to the final decision, the list of potential successors should be narrowed down to two or three names. In case none of the internal candidates meet the requirements, a specialized company can be hired for external recruiting.

Irrespective of any imminent succession, Boards of Directors should periodically reconsider the degree of compatibility between the qualifications required by the company and the skills of the current CEO. The Board of Directors should, at least once a year, discuss in depth the issue of succession.

## ● ● ● ● 2.4 Open and Continuous Dialogue

The directors should exercise an active and continuous role in the evaluation of the candidates for the position of CEO and all the potential candidates. They should interview all possible successors and ask them to talk about what has been happening in their functional area or business unit, what they think about the competitors' movements or what they would do should they become CEO. They should meet the candidates, either formally through introductions or meetings with the Board, or informally in social events, and try to assess the candidates' progress. That way, the Board members will be able to form their own opinions about the candidates, instead of trusting only the current CEO. The Human Resources executive should update the Board regarding the progress of the succession planning and the evaluation of the executives. Such practices improve the Board of Directors' perception and its relationship with potential candidates, while also differentiating the spheres of control and management.

## ● ● ● ● 2.5 People Development – Roles, Rules and Criteria

The rules and criteria applied to the succession process should be established and communicated in a clear and transparent manner, to avoid future surprises. The Board of Directors is in charge of conveying these guidelines to the CEO. Given that the succession planning is no longer restricted to the position of CEO, but includes each of the company's key positions, the challenge is to align the company's changing needs and the managers' personal aspirations.

The internal candidates should understand the methods used for the evaluation of potential successors, to be able to manage their expectations, in collaboration with the Board.

Companies that are concerned with Human Capital management make use of a cyclical and continuous process to identify prospective leaders. A broad range of training and development tools are used for attracting, retaining, and developing talents, in a way consistent with the business strategy. Such tools include analysis of potential, career planning, performance evaluation, mentoring<sup>2</sup>, coaching<sup>3</sup> and mobility.

In a well-structured succession process, the Board of Directors defines clear rules and specifies in detail the skills required for each position, thus avoiding destructive competition among potential candidates. The company's future needs are forecast, new challenges and responsibilities are allocated to the leaders, so that potential successors can be prepared to occupy executive positions.

# 3. The Role of the Board of Directors

## ● ● ● ● 3.1 Responsibility for the Succession Planning Development Process

There is general agreement that the succession process for the position of CEO and for the company's other key positions is one of the Board of Directors' responsibility and one of its greatest and most important contributions. Therefore, all Board members should participate in the process, regardless of the creation of a committee intended for such end<sup>4</sup>.

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2. *Mentoring: Guidance and preparation of a professional by a tutor with experience and knowledge about a certain functional area and/or the company.*
  3. *Coaching: Assistance for reaching relevant results, based on objectives set by the professional. Focuses on behavioral and/or functional skills and on the necessary action to accomplish such objectives.*
  4. *See item 2.31 of the IBGC Code of Best Practices of Corporate Governance, 4th edition, available on <https://conhecimento.ibgc.org.br/Paginas/Publicacao.aspx?PubId=21131>*
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Additionally, it is agreed that, whenever possible, the participation of the CEO is recommended, and that part of his duties is to prepare and evaluate potential successors. This participation, however, has an advisory, rather than a decision-making nature, since the final decision on the choice of the successor is made by the Board of Directors.

## ● ● ● ● 3.2 Development and Agreement on the Selection Criteria

The criteria for the selection of the new CEO and of the company's other key executives should begin with the description of the ideal candidate's profile and be determined, detailed and approved, preferably unanimously, by the Board of Directors. Normally, unsuccessful selection procedures are those conducted without the appropriate diligence. In such cases, the Board adopts an excessive amount of selection criteria, or recruits based on generic qualification. The lack of an active participation and Board of Directors' approval as to the essential qualities of future managers makes an agreement about a suitable successor almost impossible.

## ● ● ● ● 3.3 Knowledge and Evaluation of the Candidates

Part of the challenge in selecting the best successor is to obtain the information needed for a sound assessment of the candidates. By attending meetings or discussions without the formal presence, but with the knowledge, of the CEO, the directors may acquire a broader overview of the potential successors' values, beliefs, skills, perspectives, leadership style and degree of interaction. Limiting the contact with potential successors to presentations at the Board meetings may impair the directors' perception and lead them to approve candidates that did not undergo a critical analysis. Another good practice is to hold off-site planning meetings where, besides presentations, there is opportunity for integration and observation. The Human Resources Committee<sup>5</sup> will be in charge of coordinating the executives' evaluation practices and providing the Board of Directors with information and recommendations. An additional contribution can be provided through internal processes of evaluation of performance and behavioral skills that include subordinates and peers. Finally, external advisors can be hired to facilitate the process and ensure professionalism and transparency.

## ● ● ● ● 3.4 Difficulties for the Succession Planning

The Board of Directors frequently faces difficulties with succession planning, since, at the core of the process there are issues related to transference of power, personality, ego and mortality. Other factors that might challenge the Board are:

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5. See item 2.31 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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- The absence of efficient dynamics within the Board of Directors.
- The lack of a well-defined succession planning process.
- Shortage of internal talents that are suitable for leadership positions.
- The inability to objectively evaluate potential candidates.

Boards of Directors should be aware that few things are more important to a company than to have the right leaders in the right positions, currently and in the future. The requirement of talent does not mean that the directors are required to be talent managers. It means that Boards of Directors are required to ensure an adequate process of talent management in the company and to have the necessary knowledge about the main leadership.

## 4. Executive Management Succession

### ● ● ● ● 4.1 Overview

Even though the relevance of the Board of Directors has increased in the last years, with emphasis on the role of the Board chair, the importance of the CEO to the company should not be disregarded. On the contrary, experience has shown that the transition period for the position of CEO has the potential to transform the life of many of those involved in the process: the successor, the predecessor, the unsuccessful candidates; it also affects in many ways the company's performance, sometimes for years, through the impact it has on all stakeholders.

Some of the reasons that lead to the replacement or succession of the CEO are age, changes in the macroeconomic environment, results below expectations, internal mobility, health issues, and even financial scandals. Presumably, such reasons have intensified in the last years, considering the reduction in the average length of time executives occupy the position, according to some surveys<sup>6</sup>.

#### 4.1.1 Types of Succession Planning

A relevant aspect in any succession planning is predictability. It distinguishes a succession planning from a contingency plan.

Companies' daily activities are, however, more unpredictable than recommended. An unexpected illness, an early death, an invitation from another company or a competitor, a sudden shift in

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6. Study conducted by the consulting company Booz Allen Hamilton for the period 2000/2009. The document shows that in the last decade there has been a decrease in the average length of time CEOs serve the same company, from 8.1 to 6.3 years.

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market conditions which results in the need for a new professional profile, performance problems, these are a few of the events faced by the company and against which it must react.

A contingency plan is only a succession planning adapted to withstand an unexpected or an emergency. Again, they differ by the moment the contingency occurs. It can happen in an advanced phase of the succession planning and be properly settled, or it can happen before the planning has even been created.

In this context, there can be three types of succession planning and, in general, Boards of Directors tend to best perform the first two. The first type is called “designated replacement”, “name in the envelope” or “emergency” succession planning – the Board of Directors already has someone ready to step in and fill the position, in case the CEO resigns, becomes disabled or suddenly passes away. The second type is called “target date” or “departure defined” succession planning – the Board of Directors knows in advance when the CEO will be leaving the company, what allows it to begin an orderly process in selecting a successor. Finally, the third type is centered on uncertainties or on deteriorating situations. Boards of Directors usually are less capable of handling succession when, after a few months, they realize the need for an early replacement of the CEO, due to a disappointing business performance.

## ● ● ● ● 4.2 Alignment with the Company’s Culture

Each company has its own strategy, operating and management models, culture, and people. Therefore, Boards of Directors should carefully consider what “skillful” means when recruiting external managers either for the position of CEO or for any other executive position.

When the Board of Directors recruits external senior executives, it should look for professionals that are somewhat aligned with the company’s culture, beliefs, and values. Even if the executive has a different management style, the core values should be the same.

An external manager may give rise to conflicts when trying to implement practices that the company rejects. On the other hand, some companies call for a cultural transformation and critical executives. In such cases, Boards of Directors should be prepared to assist the new CEO to carry out difficult changes. Sometimes they do it in a proper manner, stating publicly that they expect radical changes, thus minimizing criticisms.

## ● ● ● ● 4.3 The Succession Process

Succession planning is the process that allows for the identification and development of one or more candidates who have the knowledge, experience, skills, and attitudes necessary and sufficient to replace the current occupant of a given position and to ensure that the company’s strategy is implemented in the medium and long term, in order to reach the expected results and the company’s longevity.

It should be pointed out the importance of time factor for the company's CEO succession planning, what is to say that business forecasts, including threats and opportunities, may impact the definition of the ideal profile for the succession and, thus, the evaluation of potential candidates.

A well-developed succession planning has higher chances of success and should encompass three different, but clearly linked, phases:

### 4.3.1 Before the Succession

This phase begins with the initial conversation between the Board of Directors and the current CEO regarding the latter's succession. Such conversation is not really relevant, but is the starting point for the process, and can be an opportunity for the Board of Directors to evaluate the CEO's sensibility, ideas and expectations regarding this subject, and to guarantee the CEO's commitment to the process.

When does this phase take place? Ideally, some years before the moment the executive is expected to leave the company. In this pre-succession phase, the profile of the ideal candidate should be defined in detail and with precision and should include the required experience, skills, knowledge, personality traits, leadership style, among other factors. Such profile should be in line with the Board of Directors' and CEO's medium- and long-term vision for the business and for the company.

Usually, there is an initial list of potential candidates created by the People Committee (or, where the committee is absent, by the Human Resources Executive Board), based on the criteria defined by the Board of Directors for the process. Most of the times, a successor from the company has precedence over external candidates.

Only after a lack of internal candidates is ascertained or if the implementation of a contingency plan is deemed necessary, should an external solution be considered.

In such case, the company may need to hire an executive recruiting and selection firm, even if, as a result of the contingency plan, it has a list of external candidates.

There is a global trend, analyzed and discussed in studies about the matter, for Boards of Directors to conduct a type of in-company test and leadership training which could be applied to the sales executives (CSO<sup>7</sup>), operating executives (COO<sup>8</sup>), financial executives (CFO<sup>9</sup>), and others of equal importance, before they become in charge of running the company.

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7. CSO – Chief Sales Officer

8. COO – Chief Operations Officer

9. CFO – Chief Financial Officer

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In this context the executives will have the opportunity to learn from the experience of being exposed to challenges in areas other than the one they are familiar with. The two most efficient ways of enhancing the executives' learning and development are to assign challenges to them and make them respond to crisis. A third way would be to assign them responsibilities over a smaller organization unit, which will allow for greater action autonomy.

This last option can also be applied to externally recruited executives. In this last case they are first integrated into the company's operation and, after a proper time, they are promoted to the position of CEO or other high leadership position in the company's hierarchy.

These practices allow the Board of Directors to assess the performance of the executive, while also allowing the executive to get acquainted with the peculiarities of the company and of the business.

### **4.3.2 During the succession**

Internal potential candidates are usually nominated by the CEO or by the HR Committee Council, with the participation of the HR senior executive. These nominations should be justified and validated by the profile set by the Board of Directors.

The evaluation of potential candidates is conducted by the Board members, through private or joint interviews. The evaluation should be as comprehensive as possible and should include, besides the usual evaluation tools, other means, such as direct interaction between the Board of Directors and the candidates, visits to the candidates' working environment, joint visits to clients, obtaining personal and financial references and even designation to special projects, thus allowing for a broader evaluation of the candidates' performance by the Board.

Many times, a promotion to an interim position can be an adequate step of the evaluation process of the candidates that have the preference of most of the Board of Directors. Other times, a position or project that enable a lateral movement can be suitable to improve the candidates' knowledge about the company's different businesses and functional areas.

This evaluation of the candidates gives rise to specific qualification and development needs that can be addressed through formal training, mentoring and coaching. Both the candidates' training and the progress monitoring are important part of the succession process.

In this phase, the Board of Directors should evaluate the consequences of choosing one candidate over the others, with regard to impact on the business, retention of unsuccessful candidates, reaction of the stakeholders, impact within the company and so on. This is a sensitive issue that requires specific actions, which are normally developed in the third phase of the succession process.

The second phase of the succession process ends with the choice of the successor.

### 4.3.3 After the succession

The third and last phase of the succession process addresses the consequences of the successor choice for the company and for the stakeholders.

The replaced CEO, after leaving the company, should also be subject to special care and attention, in some cases being invited to remain in the company as advisor to the new CEO, for a determined length of time. However, there are controversies as to whether such practice really is efficient or if results in division of power.

The Board of Directors is in charge of defining the new term, objectives, performance expectations, performance indicators and of supervising the new CEO, providing political and material conditions for a safe progress.

Coaching is a healthy practice and may effectively provide help regarding the new CEO's first movements and actions in the company. The coach should be an experienced professional dissociated from the company, its directors or its executives. In addition, the new CEO should regularly receive feedback from the Board of Directors for continuous performance improvement.

If the process is transparent, unsuccessful candidates will also have a smooth acceptance of the result. Otherwise, a respectful termination agreement is the best way out.

## ● ● ● ● 4.4 Risks of the Process

Most of the companies do not dedicate time to a CEO succession planning until it is too late. A company that does not address the issues of leadership succession planning and talent development may experience the consequences when facing a crisis.

On the other hand, a well-defined CEO succession planning is not sufficient if, after choosing the successor, the company neglects the successors adaptation to the new position or fails to give support to the unsuccessful candidates, who commonly leave the company transferring important experience and information to competitors that are eager to hire them.

The losses that result from a poorly conducted CEO succession can be big and lengthy and may pose a significant impact to the corporate image.

Some errors committed by the Board of Directors may lead the succession process to a failure. Examples of such errors are:

- Conducting a superficial succession planning that is more concerned with market requirements than with the company's real needs.
- Delegating excessive authority to specialized advisors, without involving the Board of Directors and the current CEO in the succession process.

- Defining a profile for the new CEO dissociated from the company's internal and external realities, and from its medium and long-term business plans.
- Incorrectly evaluating the actual interest and motivation of the succession candidates.
- Disregarding external options, concerned that such measure may be interpreted as a flaw in the internal succession process.
- Failing to evaluate the impact of the choice of a certain candidate on the company and stakeholders.
- Neglecting the question of retention of unsuccessful candidates, losing them to the market; this situation is especially serious when referring to the company's key executives.
- Failing to give support to the new CEO, especially during the first two years.

## 5. Succession of the Directors

### ● ● ● ● 5.1 Introduction and Principles

Despite the fundamental importance of management succession planning, a minority of the companies observes this practice, which is even less adopted by the Board of Directors. Its importance, in this case, is linked to the message conveyed. How the Board treats the issue will set the manner the company will treat it as well. Therefore, the level of seriousness and professionalism the Board, which is the most important body in a governance system, adopts with regard to its own succession issues, reflects on and encourages similar actions by other bodies within the company.

Given its increasing importance for good governance, the directors planned succession has been requiring the companies and their Boards to be better prepared. A well-structured Board of Directors has more chances of following and supporting the company's development. A director planned succession process, in this context, ensures a smooth transition and allows the Board to focus on its strategic and decision-making attributions. A Board succession means an effort to pursue performance improvement through an objective, transparent, orderly and constructive view. "What type of Board is desired? Why?" are some of the questions that will set the direction of the succession process within the Board of Directors.

The following responsibilities, among other attributions of the Board of Directors, should be highlighted<sup>10</sup>:

- Protecting and appreciating the company.
- Enhancing the long-term investment return.
- Balancing the expectations of shareholders and other stakeholders).
- Protecting the company's values and purposes.
- Outlining its strategic guidelines.
- Preventing and managing situations of conflicts of interest.
- Managing differences of opinion.
- Continuously supporting and supervising the company's management with regard to businesses, risks and people.
- Being accountable to partners, which includes providing opinions about the Management reports and financial statements, and suggesting the managers' annual compensation, for deliberation at the Board's meeting.
- Hiring, evaluating, paying compensation, supervising, and dismissing the CEO and other executives.
- Conducting the succession process of the directors and executives.
- Giving support to the CEO.

Another possible role that can be assigned to the Board of Directors is preparing a CEO that is apt to undertake the tasks of a director, especially in family companies or in companies with a defined control block.

The main measures the Board of directors should adopt to conduct a director's succession process are:

- Defining the director's qualification standards.
- Determining the director's range of attributions, to be detailed in the articles of incorporation (or organization) or the Internal Rules of the Board of Directors.
- Specifying the director's compensation.
- Defining criteria and conducting a director's annual evaluation.

In general, Boards of Directors should have a set of documents which describes the purpose, roles, responsibilities, and attributions of the body, as well as the expected qualifications of each current and future director.

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10. See item 2.3 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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## ● ● ● ● The Profile

The companies should, considering the mission, perspective, beliefs and values, culture, and short- and long-term objectives of their business, define the Board members' profile. The company's interests should always prevail, and, to such end, the selection process have to be free from conflicting interests and must be based on technical and objective criteria, considering the necessary experience, skills, and professional and personal styles. The definition of the profile will prevent the company from hiring directors who are unprepared for the corporate challenges or who have a poor performance. When nominating directors, the partners should take into consideration the specified profile.

Candidates for the position of director should be familiar with the company's businesses and with the specific problems it faces, or else the candidate should be able to acquire such knowledge through reading and understanding the company's reports. A structured succession process can provide the stakeholders with a safer recruiting and selection of directors, thus helping to perpetuate the company.

For their turn, the directors should have at least the following qualifications<sup>11</sup>:

- Alignment with the company's values and Code of Conduct.
- Capacity of defending their own point of view, based on their beliefs.
- Time availability.
- Motivation.

Additionally, they should have:

- Strategic vision.
- Knowledge of the best practices of Corporate Governance.
- Teamwork capabilities.
- Capacity to read and understand management, accounting, and financial reports.
- Notions of corporate law.
- Perception of the company's risk profile.
- Experience and technical expertise in one or more areas of interest to the company.

Directors should also be free from conflict between fundamental interests (that cannot be managed, are not specific or contingent and are permanent, or expected to be permanent) and attentive to the company's issues. They should also understand that their duties and responsibilities are broad and not restricted to the Board's meetings.

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11. See item 2.5 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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The aspect of independence differs according to the company, but in general the directors should follow the standard, avoiding conflicts of interest and focusing on the corporate interest.

Additionally, the candidate to the position of director should mostly have the following experiences<sup>12</sup>:

- Professional activity as a company's senior executive.
- Academic activity with significant contribution to society and to entrepreneurship.
- Experience in corporate governance through participation in, and assistance to, other Boards.
- Participation in specific governance entities that promote discussion and training on the issue.
- Voluntary participation in non-profit companies' Boards, to acquire experience.
- Director certification addressing all aspects of governance, particularly those related to corporate finance.

### 5.2.1 Overlapping of Roles

The good practices of corporate governance recommended by the IBGC have a clear and transparent position with regard to the roles of CEO and Board chair. Those two roles should be held by different individuals to avoid concentration of power, which impairs an adequate supervision of the company's management<sup>13</sup>. In this sense, the Board chair's and the CEO's attributions are different and complementary; for such reason, it is recommended that the CEO attends the meetings of the Board of Directors as a guest.

Due to the importance and complementarity of both positions, separating them is relevant for the company, since it avoids that termination of one executive would result in the vacancy of two key positions.

### 5.2.2 The Role of the Board Chair

The primary role of a Chairman is to ensure the Board effectiveness and the good performance of each one of its members, being also responsible for establishing objectives and programs, chairing the meetings, organizing and coordinating the agenda, coordinating and supervising the activities of the other directors, assigning responsibilities and deadlines, supporting the creation of committees - such as audit committees, HR (which includes compensation), governance, finance and sustainability - and lead the succession process. In addition, in accordance with the principles of good governance, it must monitor the evaluation process of the board and of the directors, and ensure that they receive the complete information in a timely manner, for the exercise of their mandates. The Board of Director succession should be treated as a priority since the beginning of the board chair's tenure and be included in the discussions about strategic planning and annual evaluation.

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12. See item 2.4 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

13. See item 2.10 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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The board chair should also encourage the directors to go past their duties and formal responsibilities, confirming their duties to oversee governance.

## ● ● ● ● 5.3 Guidelines for the IBGC Code of Best Practices of Corporate Governance

### 5.31 Number of Directors, Term and Age Limit<sup>14</sup>

The number of directors should vary according to the sector, size, complexity of activities, stage of the company's life cycle and the need of creating committees. The recommended number is a minimum of five (5) and a maximum of eleven (11) directors.

#### **Regarding term of office:**

The term of office of directors should not exceed 2 (two) years. Reelection is desirable, since it results in an experienced and productive Board; however, it should not happen automatically. All the directors should be elected in one General Meeting.

The renewal of a director's term should consider the results of the annual evaluation. The term renewal criteria should be laid out in the company's Articles of Incorporation / Organization or in the Internal Rules of the Board. The Internal Regulations should be precise about the number of absences permitted before the director is removed from office.

In order to avoid lifetime tenure, the articles of incorporation / organization may set a maximum number of years of continuous service in the Council.

#### **Regarding age limit:**

Once the requirements described in items 2.4 and 2.5<sup>15</sup> are met, age becomes a factor of relative relevance, but most important is the director's contribution to the Board, to the company and to partners.

### 5.3.2 Board Composition, and Executive, Non-executive and Independent Non-executive Directors<sup>16</sup>

Board composition depends on a variety of factors that describe the company and its environment, of which we can highlight: objectives, stage / degree of development and expectations in relation to the Board's performance. The concept of representation of one or a group of stakeholders does not apply to the Board composition, since the director has duties towards the company and, thus, towards all stakeholders. Therefore, the director is not linked to any specific individual.

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14. See items 2.6, 2.7 and 2.14 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

15. References to the IBGC Code of Best Practices of Corporate Governance, 4th edition.

16. See items 2.4 and 2.15 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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When appointing members to the Board, the company should create an environment that allows for the free expression by the directors. In any case, diversity of experience, qualifications, and behavioral styles should be pursued by the Board to obtain the necessary skills for the exercise of its duties.

There are three (3) categories of directors:

- **Independent non-executive directors:** (see 2.16<sup>17</sup>)
- **Non-executive Directors:** those that are dissociated from the company, but not independent. For example: former executives and former employees, lawyers and advisors who provide services to the company, partners or employees of the controlling group and their close relatives, etc.
- **Executive Directors:** company's executives or employees.

## ● ● ● ● 5.4 Appointment and Selection Process

The qualification and criteria to be observed for the selection of directors must be laid out in the company's Articles of Incorporation (or Organization) or governance policies. Usually, this responsibility belongs to a governance committee or a Human Resources committee, which can receive nominations from shareholders and is assisted by specialized advisors.

The size of the Board of Directors and the dismissal or appointment of new directors are defined at annual shareholders' meetings, except in case of dismissal by judicial means, which may require an extraordinary meeting.

According to good practices, the choice and replacement of directors should meet two basic requirements: recognized qualification and independence. Recognized qualification is understood as the highest degree of professional and personal ethics, values, integrity, and commitment to the shareholders' long-term interests and to the company's longevity.

## ● ● ● ● 5.5 Preparation and Integration of New Directors

The process and the formalization of appointment of a new director are relevant for corporate governance purposes, as this director will be responsible – individually and jointly with the company – for any omissions or acts performed and consequent losses. This implies a high degree of corporate liability with economic and financial impacts for the company and impact on the director's assets. Thus, the investiture of a new director should be a planned and structured process and should be revised regularly.

A good preparation and integration plan for new directors should provide an immersion in the company's values and beliefs, mission, vision, and culture. New directors should also study the com-

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17. *References to the IBGC Code of Best Practices of Corporate Governance, 4th edition.*

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pany's sector and competitors, visit its facilities, and interact with the other Board members, to align expectations and understand the company's strategy and the decisions to be made.

## ● ● ● ● 5.6 Basic and Continuous Education<sup>18</sup>

The director's responsibility and accountability to shareholders and stakeholders re-inforce the importance of preparing the director for a good performance. New directors with no experience in corporate governance should be required to take courses and attend national and international certification programs, provided by the company or on their own initiative. The directors will thus benefit from a process of constant development of the required skills and practical experiences.

# 6. Succession Planning in a Family Business

In general, the phases of a sound succession planning process also apply to a family business. However, experience has shown that preparing and selecting a family member to occupy a leadership position in the company is a subjective and delicate matter, since, generally, it:

- Requires patience, time and dedication, being a long and complex process.
- Leads to reflection and consternation, due to the need to evaluate a family member; it also brings a feeling of limitation to the replaced individual.
- Involves diverse expectations and perceptions from members of different generations.
- Involves matters related to assets and money, which can be a taboo subject within the family.

Thus, for the succession process to make sense and fulfill its function, the entrepreneurial family needs to analyze and answer questions such as:

- Is the family interested in running the business and occupying leadership positions?
- How advantageous is it for family members to remain in the company?
- Are the current shareholders, or their heirs, apt to run the business(es)?
- How will the company perform in the next generation, the generation after the next, and so on?

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18. See item 2.17 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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The answers to these questions define how the process will be structured, so dealing with and deciding on them are the starting point of a family succession planning. Even leaving the business can be an option, depending on the decision of the controlling shareholders; such measure can be carried out through the sales to other family members, third parties, or the company's current managers (management buy-out).

Succession planning is an important tool for identifying and developing successors, either family members or not, who will preserve the mission and values of the company.

A structured and prepared family will provide better conditions for discussing and deciding on such matters; it will also favor greater involvement and participation by the partners from the family, in merging the interests of the family and of the company.

## ● ● ● ● 6.1 Characteristics of the Process

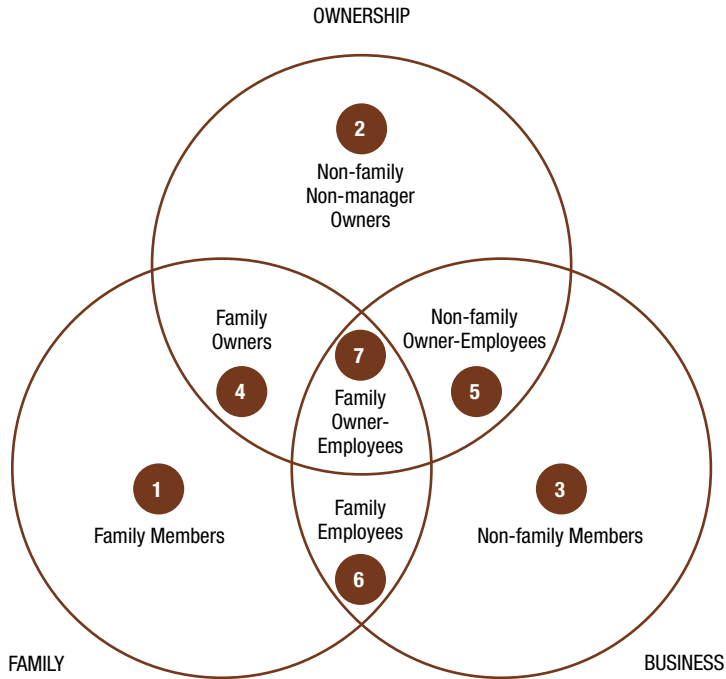
When it comes to family succession, there should be no strict or fixed rules. Each family presents a different situation, so intangible aspects, such as specific characteristics, history and family ties need to be considered. Some aspects that make any family succession a unique process are presented below:

- Succession planning is a collective process and requires commitment and consensus from the whole family(ies), partners or heirs, either leaders or not.
- To preserve the assets (tangible and intangible), the family must foresee the problems, mainly those related to the company's continuity, and act before internal conflicts occur.
- A business model valid in one generation may not be valid in the next. Trust and respect are not inherited, they are conquered;
- Business profitability does not grow in proportion to the family, so in the company there is no room for every member of the family. Succession planning combined with each family member's life project, is essential for the financial independence and subsistence of future generations.

### 6.1.1 Succession Involves 3 Systems

In a family business, the 3 systems, family, asset, and company, are integrated and connected by members who have different characteristics and expectations.

Each system has its own motivators and interests. In the company, the focus is on competence, meritocracy, and results; in the family, the rules are based on emotional criteria, such as a preference or affinity. If, for example, the family experiences poorly solved issues or difficult problems, it will likely struggle to make important decisions, putting the company at risk. Therefore, the more the systems overlap, the greater the risk of a conflicting relationship. The family that runs a business has the challenge of knowing and managing the interests in each circle, thus minimizing the influence and negative interference of the family in the business or of the business in the family.

**Figure 1 – Three-Circle Model of the Family Business System**

Source: Davis, J. A. and Tagiuri, R. "The Influence of Life Stage on Father-Son Work Relationships in Family Companies." *Family Business Review* (spring, 1989).

Personal and family conflicts vary according to the generations – the founder, the children, the grandchildren, the cousins, etc. – and to the life cycles – childhood, adolescence, youth, adulthood, and retirement. Knowing and understanding each generation's characteristics, moment and expectations is an important premise for the preservation of the family's well-being and the company's health.

In this sense, the professionalization of the three systems through the adoption of adequate corporate governance structures and the separation of the issues in different discussion boards contribute significantly to prevent abuse of power, overlapping between personal and company's interests, and, consequently, internal conflicts. The form and quality of the relationship within the family will determine, to some extent, the types of culture and impacts on the company.

### **6.1.2 Succession May Occur from One Generation to the Other or Intra-Generation**

As most businesses do not grow in the same proportion as the families, the greater the number of family members, the greater the need for a professionalization of the management and of the relationship between the partners. Also, the company's structure becomes more sophisticated, beginning by the corporate models and agreements. Such tools are important guides for the definition of:

- Which family members have vocation to run the business in the future.
- Which relatives, including spouses and in-laws, can work in the company.
- What the rules on removal of those who are not aligned with the objectives and needs of the company are.

### 6.1.3 The Need of Successor Legitimacy

Succession is transfer of power. But a formally transferred power, which is not based on competence and leadership, does not hold up. A successor's legitimacy from the perspective of the family or of other stakeholders, should be based on technical skills, leadership skills and principles and values. Everyone – family, non-family shareholders, the Board of Directors, the executives and employees – on the other hand, contribute in some way to the construction of relationships of trust and respect, with which the next leaders will carry out their new role.

## ● ● ● ● 6.2 Corporate Governance and Family Council

The principles and instruments of corporate governance apply to the family business succession, as guides and facilitators in the process, helping to regulate and discipline the relations between the family and the company.

### 6.2.1 The Family Council

The Family Council is one of the main tools for this purpose. Family organizations should consider implementing a Family Council, which consists of a forum for discussion of family matters and align the members' expectations towards the business.

The responsibilities of the Family Council are<sup>19</sup>:

- Defining the limits between family and business interests.
- Preserving the family values – history, culture, and shared vision.
- Defining and agreeing on criteria for asset protection, growth, diversification and management of real estate and movable property.
- Creating mechanisms, such as a participation fund, for the acquisition of ownership interests from other partners in case of withdrawal.
- Planning the succession, transmission of assets and inheritance.
- Considering the company as a factor of the family unity and continuity.
- Assisting the family members in the company's succession, considering vocational aspects, professional future, and continuing education.
- Defining criteria for the nomination of members for the Board of Directors.

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19. See item 1.9 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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The objectives of the Family Council should not be mistaken for those of the Board of Directors, which are geared towards the company. As for succession issues, the Family Council should discuss and define principles and criteria for the formation and choice of future leaders, considering the company's needs. After defining what will be the family's participation in the development of the business, the Family Council should inform the conclusions to the Board of Directors. From then on, the Family Council will be able to continue the succession process, in an independent manner and with no surprises.

The Family Council is responsible for giving support to the heirs regarding vocational aspects, in making them aware of their future role as a shareholder and in developing the skills required for the business. It may also encourage its own projects or the heirs' new ventures, supporting the creation of new paths.

Finally, the Family Council should deliberate jointly on issues related to the future of the company, to assess risks and anticipate consequences:

- If there is no family candidate, would the family be open to hiring a professional from the market? If it would, how to ensure that such professional is in line with the company's culture?
- Are the family and the company prepared to deal with possible disputes between candidates – either family members or not?
- If the choice falls on a professional that is not a family member, what treatment will be given to the unsuccessful candidate(s)?

If these questions are clear and settled within the family and if the directors and executives provide significant support, the partners from the family will be able to depart from day-to-day operations. Also, the relationship between the three levels of power, shareholders, boards / councils, and managers, will become more structured since the points-of-view will converge on the business interests.

Family members can occupy positions in the following bodies: Family Council, Board of Directors, Fiscal Council, or Executive Management. However, regardless of the position occupied, professionalization is always necessary, and the preparation of the heirs should begin as soon as possible, to ensure a better qualification or to show to the younger generations and to the company's employees that heirs will not always become partners. They should show competence and knowledge about the business.

Many families want to develop the heirs away from the vices of the company and without carrying the stigma of "owner's son" and the pressure of "being a heir"; thus, the heirs are required, before stepping into the business, to obtain professional experience in other companies, in the country or abroad, for a minimum period of three (3) years and to pursue a postgraduate or specialization diploma from a renowned institution.

Also, in the Family Council, important documents regulating family relationships are discussed, prepared, and signed:



- **Company's Code of Conductor Family Protocol:** this document reinforces the values and ethical principles and the family legacy; it also guides the moral conduct, with the end of preserving the corporate relations;
- **Shareholders Agreement:** this document defines the company's moral and legal rules, setting apart the spheres of assets, family, and company. This document contains the following:
  - Rules for the admission, removal, promotion, and compensation of the family members by the company.
  - Rules on the management and right to use the family's assets.
  - Dividend policy.
  - Criteria for retirement;
  - Mechanisms of prevention against company dilution and decapitalization. A good shareholders' agreement<sup>20</sup> protects the family from a hostile takeover, increasing its chances of keeping the corporate control and protecting the three systems – family, assets and company(ies) – from stressful and unnecessary lawsuits; it also prevents people without blood ties from entering the company, as often happens in cases of transfer of assets due to death, dissolution of marriage, custody of minors and will;
  - Provisions regarding the exercise of voting rights at the general meetings.
  - In smaller companies, which have less complex structures, the Partners' Meeting<sup>21</sup> can act as Family Council.

## ● ● ● ● 6.3 Resistance to the Succession Planning: Why Is It So Usual?

Sometimes, the founder of a company, while still alive and active, may transfer the business to a successor of the next generation, in a professional and cordial manner. Such transition process is often difficult. Other times, the founders, even though motivated and aware of their mission, cannot find any prepared or interested successors.

In fact, there are many obstacles throughout a family succession, related to the people involved – the founder, the family, employees, customers, and other stakeholders:

- The Founder – most of the time is the greatest obstacle to a professional succession planning, in view of the strong desire to continue ahead or in control of the company. The founder's fears and anxieties arise mostly from:

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20. See item 1.3 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

21. The most powerful body of a limited company. According to the new Civil Code, if a company has more than 10 partners, the deliberations should be made in a general meeting. If the company has 10 or less partners, the deliberations can be made in a simple meeting. The call and installation of the partners' meeting of the limited liability company, as well as the procedures related to the works during the meeting are like a corporation's general meeting.

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- The idea of death or incapability.
- Reluctance to leave the leading position. The transfer of authority can mean an enormous sacrifice, since, in most cases, the entrepreneurs dedicate a large part of their life to the company.
- Choosing one successor among the children. In general, the principles that govern business demand choices based on competency. The family values, however, may persist;
- Loss of identity and fear of retirement. Founders usually identify with the business, justifying their place in the world, based on their relationship with the company. Thus, the withdrawal from the position can lead to lack of motivation or life purpose.
- Resistance to planning. Founders are more likely to perform than to plan.
- Skepticism: Entrepreneurs usually think that no one can lead the business as well as they do.
- The Family: contributes to the creation of obstacles when:
  - Family cultures discourage discussions by its members concerning the future, financial issues, and death, among others.
  - Spouses, by fear of losing their position in the company, become resistant to changes.
- Employees: those with a close relationship with the founder may see a new leader as a threat to their status quo.
- Clients: a new actor on the scene can risk the relationship between the parties.

## 7. CONCLUSION

Succession planning is an important management process that has many purposes. It:

- a) identifies and develops successors, in line with the strategy agreed by the partners and the Board of Directors.
- b) gives continuity to the company's mission and values.
- c) conveys transparency and attention towards the market – suppliers, clients, minority shareholders, partners, and members of the controlling family, where they exist.
- d) prepares leaders based on clear criteria, promoting the growth of individuals and companies.

# Part II:

# Evaluation

## 1. Introduction

The 4th Edition of the IBGC Code of Best Practices of Corporate Governance clearly recommends the annual and formal evaluation of the Board of Directors as a collegiate body, of the individual directors, and of the Executive Board, notably the CEO. These evaluations should be conducted by the Board of Directors, with the leadership of the Board chair<sup>22</sup>.

In general, the formal evaluation process has been increasingly adopted by the companies, as an important governance element. Regardless of the size of the company, its capital structure, its segment and the market in which it operates – national or international – the regular evaluation of Boards and directors tends to be incorporated into the corporate culture.

## 2. Evaluation Process

### ● ● ● ● 2.1 Objectives, Reasons and Barriers related to the Process

The overall purpose of a performance evaluation process is to review and analyze the individual or group contributions in achieving the established objectives, to obtain, in the future, more efficient and effective results for the business.

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22. See item 2.18 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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The specific purpose, in this case, is to evaluate the contribution of the Board as a collegiate body, of the individual directors, and of the Executive Board, represented by its CEO, to obtain continuous improvement and renewal.

Other relevant objectives for the evaluation process are:

- Ensuring that the Board performs its fundamental activities of directing the corporate strategy and supervising its performance.
- Improving the alignment between the Board's profile and the corporate strategy.
- Enhancing the processes, flow of information and relation of the Board of Directors, executive board and controlling bodies.
- Improving the support given to the CEO.
- Improving the process of attraction and renewal of directors and Executive Board.
- Improving the Board's credibility, by disclosing information on its performance to the company and shareholders.
- Assessing if the actions carried out by the CEO are appropriate for executing the company's strategic direction.
- Giving support to the Board of Directors' variable compensation process, if any.

There are several reasons that justify the adoption of an evaluation process for the Board, directors, and Executive Board, which:

- a) Allows to assess the performance of the individual or group and shows the need of knowledge, skills, or behavior reviews.
- b) Responds to external control forces, such as institutional investors and corporate rating agencies.
- c) Responds to internal pressures, which demand the recognition and improvement of weak spots.
- d) Can bring about necessary changes in the profile of the Board and the Executive Board.
- e) Promotes greater alignment between the Board of Directors and the Executive Board in relation to the established objectives.
- f) Improves the efficiency of the Board of Directors' activities: agenda, internal dynamics, time management and matters.
- g) Helps to develop the evaluation process, through constant criticism and improvement to the adopted system.
- h) Helps to certify whether the directors' skills are in accordance with changes in the business and with the company's life cycle.
- i) Serves as basis for the election process, indicating to shareholders if the Board members should be maintained or replaced.

The adoption of evaluation practices presents some obstacles, such as:

- i. Lack of clarity as to what a board evaluation is and its differences when compared to the evaluation of executives.
- ii. Resistance on the part of some shareholders in accepting the evaluation of directors appointed by them.
- iii. Directors' ego or insecurity.
- iv. Questions about the criteria established for the evaluation.
- v. Embarrassment of the evaluators due to close personal relationships, among others

Also, some factors can weaken the process, especially when the evaluation is perceived as:

- Unfair or biased.
- Innocuous and useless, not adding value, improving or innovating.
- Source of conflict, due to the interests of political groups.
- Bureaucratic procedure for complying with a formality.
- An instrument used by unprepared evaluators and evaluated individuals.
- A tool based on inappropriate metrics.

The active participation of the Board of Directors in the construction of the evaluation system can reduce or eliminate the resistance to it. In this sense, it is recommended that the Executive Board's evaluation, prepared by the CEO, be validated by the Board of Directors.

Another measure that can help minimize barriers and increase the acceptance of the process is the definition of the evaluation purposes and the establishment of criteria, which should be clear and perfectly connected with the company's mission, vision, values, strategy, and culture.

## ● ● ● ● 2.2 Principles and Guidelines: What Should Be the Basis for the Evaluation of the Board of Director, Directors and CEO

The basic principle is to assess whether the Board of Directors, the Directors and the Executive Board, notably, its CEO, fulfill the roles and responsibilities accepted and pre-defined in the legislation, articles of incorporation or organization, and in internal regulations.

The determination of the items to be considered in the evaluation depends on the activity sector, the company's moment, and the company's culture related to the process and its purposes. The Board must be evaluated according to the criteria defined by the shareholders and approved by the Board. Transparency and knowledge of the process by those who will be involved in the evaluation are also fundamental<sup>23</sup>.

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23. See items 2.18 and 2.19 of the IBGC Code of Best Practices of Corporate Governance, 4th edition

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## 2.2.1 Evaluation of the Board and Directors

A formal assessment of the Board's performance and of each director, must be carried out annually. Its method should be adapted to the specific situation of the company. The evaluation should be supported by formal processes, with a well-defined performance and qualification scope.

The Board chair, who is responsible for conducting the evaluation, can hire external experts to provide objectivity to the process. Individual assessment of the directors – particularly in terms of attendance and involvement or participation in meetings (including the assessment of their lack of focus at the meetings, due to unrelated activities) – is fundamental for the approval of their reelection. The evaluation process and results should be discussed with the Board chair and, subsequently, disclosed to the partners through a specific item in the Management report.

## 2.2.2 Evaluation of the CEO and the Executive Board

The Board of Directors must establish the CEO's performance goals at the beginning of each fiscal year, and annually carry out a formal evaluation of such professional. The CEO oversees his team's performance evaluation<sup>24</sup> and establishes a training and development program. The result of the executives' evaluation must be conveyed to the Board, with the proposition that the directors remain in their positions or otherwise. The Board of Directors should analyze and approve the CEO's recommendation, both regarding the agreed goals and his evaluation.

The People or Human Resources Committee, if any, can assist the Board of Directors and the CEO in their evaluation.

## ● ● ● ● 2.3 Evaluation Aspects

For the development of the evaluation process, the following aspects should be considered:

- a) Type of evaluation:
  - External evaluation: carried out by an advisor or consulting company.
  - Internal evaluation: carried out by bodies of the Board of Directors, such as the Human Resources Committee.
  - Combined evaluation: carried out by the company with the assistance of external advisors.
- b) Object of evaluation
  - Board of Directors, as a collegiate body.
  - Directors, individually.
  - Executive Board, notably its CEO

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24. See item 3.8 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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- c) Evaluation methods
  - 180-degree or 360-degree evaluation;
  - Self-evaluation: individual assessment of one's own contribution.
  - Evaluation by peers.
- d) Data collection techniques
  - Interview (qualitative analysis);
  - Inquiry form with closed questions (quantitative analysis).
  - Inquiry form with closed and open questions.
  - Combination of two or more techniques

## ● ● ● ● 2.4 Evaluation Tools

Some examples of the dimensions and issues to be considered in the evaluation of the Board of Directors, directors and CEO of a company are given below.

### 2.4.1 Board of Directors and Directors Evaluation Form

#### I – BUSINESS STRATEGY AND CORPORATE RISKS

1. Are all the directors aware of and understand the company's mission, vision, values, strategy, and business plans?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
  
2. Does the Board of Directors properly supervise, throughout the year, the strategic plan, and the budget, and keep track of the progress, comparing what was planned and what was achieved?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable

3. Are the directors focused on the business strategic issues of the company, its subsidiaries and its controlled companies, giving priority, at the Executive Board, to the issues that are most relevant and impact the results the most? In addition, do they follow the actions of the Executive Board?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
4. Does the Board of Directors supervise the internal control processes, verify if they are appropriate for identifying and monitoring risks and protecting the assets, and guarantee the precision and quality of the information provided by the Executive Board?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
5. Does the Board of Directors supervise and have regular discussion with the Executive Board regarding corporate risk management and exposure to risks that may impact the company's results and longevity or destroy value for shareholders?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
6. Does the Board of Directors contribute to the adjustment of the dividend policy to the company's strategic planning and capital budget?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable



## II – DYNAMICS OF THE BOARD OF DIRECTORS AND DIRECTORS' INVOLVEMENT

7. Is there diversity in the Board of Directors' composition, considering its members' age, gender, education, and experience (strategy, finance, risks, people management, technology, sustainability, etc.)?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
8. Does the Board of Directors properly interact with shareholders?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
9. Does the Board of Directors have Internal Rules and comply with it in all activities?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
10. Does the Board of Directors supervise the compliance with institutional policies and any other initiatives of the company, such as the Code of Conduct, Sustainability Principles, etc.?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable

11. Does the Board of Directors clearly communicate its information needs to the Executive Board and to those in charge of Corporate Governance? Does it receive the requested information timely and thoroughly, including the analysis of reference companies and business trends?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
  
12. Are the meetings of the Board of Directors held with the proper frequency?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
  
13. Does the Board of Directors have an agenda established in advance, covering priority strategic matters, financial reports, investment plans, human resource programs and plans for products or services?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
  
14. Are the Board of Directors' meetings structured in a way that encourages the constructive participation of all members, allowing space for disagreement, critical questioning, and adequate use of time?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable

15. Is there enough time at the Board of Directors' meetings for the discussion of the matters presented? Is there balance between the time allowed for presentation and debate?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
  
16. Do directors prepare in a proper manner for the meetings and do they participate effectively in the presentations and debates, asking appropriate and pertinent questions to the Executive Board?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
  
17. Do directors supervise the fulfillment of the established strategic objectives and participate in the debates, adding value to the decisions?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
  
18. In addition to the formal meetings, are there informal discussions that promote the integration of the Board of Directors?
  - ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable

19. Is there personal and professional respect in the relationships among directors?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
20. Does the Board of Directors have committees in number and with quality required for its needs (Strategy, HR, Audit, Finance, Sustainability, etc.)?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
21. Does the Board of Directors hold separate meetings with external auditors?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
22. Does the Board of Directors dedicate enough time and do an adequate job in evaluating the CEO?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable

23. Does the Board of Directors dedicate enough time and establish guidelines for the succession of the CEO?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable

### III – INDIVIDUAL PERFORMANCE

24. Do you consider that your personal preparation, level of dedication and availability to carry out your responsibilities are adequate?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
25. Has your predominant posture at the Board meetings been active and constructive, thus contributing to the discussions?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable
26. Do you give contribution to the creation and fulfillment of the meeting's agenda, avoiding the inclusion of extraordinary matters?
- ☐ No / It needs to be significantly improved
  - ☐ Sometimes / It can be improved
  - ☐ Most of the times / Adequate
  - ☐ Yes / Excellent
  - ☐ Unknown / Not Applicable

27. Considering the importance of your continuous improvement as a company's director, have you enrolled in refresher or certification courses?

- ☐ No / It needs to be significantly improved
- ☐ Sometimes / It can be improved
- ☐ Most of the times / Adequate
- ☐ Yes / Excellent
- ☐ Unknown / Not Applicable

28. When you have personal interest in the matter presented to be voted on, would you recuse yourself?

- ☐ No / It needs to be significantly improved
- ☐ Sometimes / It can be improved
- ☐ Most of the times / Adequate
- ☐ Yes / Excellent
- ☐ Unknown / Not Applicable

29. As a director, what are your suggestions for improving the performance of the Board of Directors?

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30. As a director, what is your proposed agenda for the Board of Directors, considering the next fiscal year?

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## 2.4.2 CEO Evaluation form

### I – STRATEGY

1. Is the company's business strategy sound?
2. Is the company in line with the direction of the strategy?
3. Are the corporate and business unit strategies being well executed?
4. How effectively has the CEO identified and anticipated real threats in the business environment?

### II – LEADERSHIP

5. Is the CEO able to motivate and give energy to the organization?
6. Does the company's culture reinforce its mission, vision, beliefs, and values?
7. Has the CEO been properly conducting the company's change process?

### III – PEOPLE MANAGEMENT

8. Is the CEO assigning the right people to the right position?
9. Does the CEO have a good relationship with the executives (or direct subordinates)? Do they do a good teamwork?
10. Does the company have qualified professionals that can be a replacement in case of succession and are they able to undertake the company's growth goals?
11. Does the CEO keep the Board of Directors informed of potential successors?
12. Has the CEO been developing leaders with the potential and skills required for succession?

### IV – RESULT INDICATORS

13. Has the company performed well and managed to be competitive in the past 12 months?
14. Are the company's sales, profit, productivity, asset employment, quality and customer satisfaction meeting the expectations?
15. Are there signs that the company will keep its good performance in the next 3 years?

### V – RELATIONSHIP WITH EXTERNAL STAKEHOLDERS

16. How is the CEO's relationship with customers, suppliers, business partners, governments, and other stakeholders?
17. Does the CEO influence or has a leadership attitude in their field(s) of activity?

## ● ● ● ● 2.5 Summary

The evaluation of the Board, as a collegiate body, of the individual directors, and of the CEO should be coordinated by the Board and led by the Board chair.

Even if the Board has a tenure of two or more years, the evaluations should be conducted on an annual basis.

The use of an inquiry form for the evaluation of the Board of Directors, or for the directors' self-evaluation, has been often adopted. The form is answered individually, and the answers are forwarded to the Board chair, who is responsible for the evaluation process, with the support of internal or external advisors. Depending on the company's culture, the Board chair may conduct the process through interviews with each director, discussing the Board's evaluation, the individual evaluation, and the evaluation by the peers, as well as the CEO's assessment.

The results of the Board's evaluation, as a collegiate body, are tabulated and presented at the immediately subsequent meeting, for discussion and action, and for determining a common agenda for the Board. This agenda may include actions aimed at improving the operation of the Board of Directors, as well as actions related to coaching, training or preparing directors for the meetings. This meeting may be also an opportunity to discuss the evaluation of the CEO. Necessarily, after each evaluation process, the group, and, occasionally, the individual directors and the CEO, should undergo a training and development program.

The results of the individual directors' and of the CEO's evaluations will be kept confidential by the Board chair, who may use the information to recommend actions for improvement and individual development. The evaluation may also serve basis for the decision as to the reelection of the individual directors, at the discretion of the Board chair and, occasionally, of the shareholders.



# Part III:

# Compensation



## 1. Introduction

The compensation a company pays to its executives represents a relevant cost, thus this issue is of interest for both the executives and the Board of Directors. Sometimes the analysis focuses on containing and reducing such costs and there may be no balance between cost management and the importance of having an effective compensation management. A well-structured compensation policy for the company's main executives can be an important instrument for competitiveness and corporate sustainability.

As known, the main challenge when defining an executive compensation strategy and policy is ensuring the alignment between these costs and the company's global business strategy. This is possibly one of the most critical tasks of the Board of Directors' People Committee. It begins with the determination of the strategic objectives of the executive compensation policy and its relations with the corporate strategic planning. Such relations will allow the establishment of the objectives, conducts and actions, for the company's executive management as a whole and for each of its members, which will lead the company towards its goals.

However, market factors create complexities for the Board of Directors' People Committee, which oversees formulating policies, when deciding on the alternatives and forms of compensation and competitive positioning. Following what the competitors have done not always is the best option. Especially if the company is not truly clear about what it wants and needs to use compensation succeed in its business strategy. Thus, companies should try to escape the temptation of following other companies and should treat their executive compensation policy a tool for corporate success.

Traditional compensation systems do not include the company's vision of the future and strategic orientation. They essentially intend to provide the company with a salary management tool. The modern company, on the other hand, uses the support systems, among which the compensation system, to promote the convergence of corporate efforts towards common goals.

## 2. Principles of Compensation for the Board of Directors and Executive Board

The company's total compensation philosophy and compensation practices for the positions of Directors and Executives (Managers, Executives, elected or otherwise) should be developed and proposed by the People Committee – also called Human Resources Committee, Compensation Committee or Governance Committee – and approved by the Board of Directors<sup>25</sup>.

The Directors' and Executives' compensation should be informed to the market in an open and detailed form; the information should include the company's total compensation philosophy, the compensation definition process, the competitive market that is being considered and the values of fixed and variable compensation, in the short and long term.

Information on the use of the global budget approved in the previous year (amount of budget and amount effectively used) should be presented at the company's Annual General Meeting (AGM). The proposed compensation for the following fiscal year, broken down by body (Executive Board, Board of Directors and Fiscal Council), the amount of fixed and variable compensation, the benefits and incentives granted should also be presented at the same occasion.

The compensation practiced by the company should motivate and direct the Directors and Executives to pursue the results defined by the shareholders. In addition, the compensation should be competitive, according to market practices, for the segment in which the company operates and respect the different types of corporate culture.

The Executives' compensation should be defined and managed within the concept of total compensation and not as a set of separate elements: fixed salary, bonuses, long-term incentives, and benefits. The same concept applies to the Directors. For them, total compensation includes fixed monthly compensation, and may also include long-term incentives.

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25. See items 2.24 and 3.9 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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### 3. Responsibilities of the People Committee

The People Committee's main responsibilities<sup>26</sup> in relation to compensation are:

- Preparing and proposing to the Board of Directors the company's philosophy and strategy of total compensation, considering the company's business guidelines, values and culture.
- Analyzing the company's competitive market<sup>27</sup> and recommending to the Board of Directors the companies that should serve as reference in this market, for the purpose of compensation surveys; such surveys will provide the necessary market data for determining the competitiveness of the compensation practiced by the company;
- Analyzing the position of the total compensation in relation to the competitive market suggested by the company's Executive Committee, and proposing, if applicable, adjustments for approval by the Board of Directors.
- Analyzing the design and impact of the long-term variable compensation / long-term incentive programs, proposing, if applicable, adjustments for approval by the Board of Directors.
- Evaluating each compensation program and, if applicable, proposing adjustments to align the interests of the company's managers and professionals with those of the shareholders.
- Analyzing the mechanisms for the Directors' compensation and proposing the amounts for the fiscal year to the Board Chair.
- Defining and proposing to the Board of Directors, the conditions and elements that will be included in the severance packages for senior executives.
- Making sure the company's compensation practices and systems are observed, thus avoiding distortions leading to loss of competitiveness and / or risks for the company.

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26. See item 2.31 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

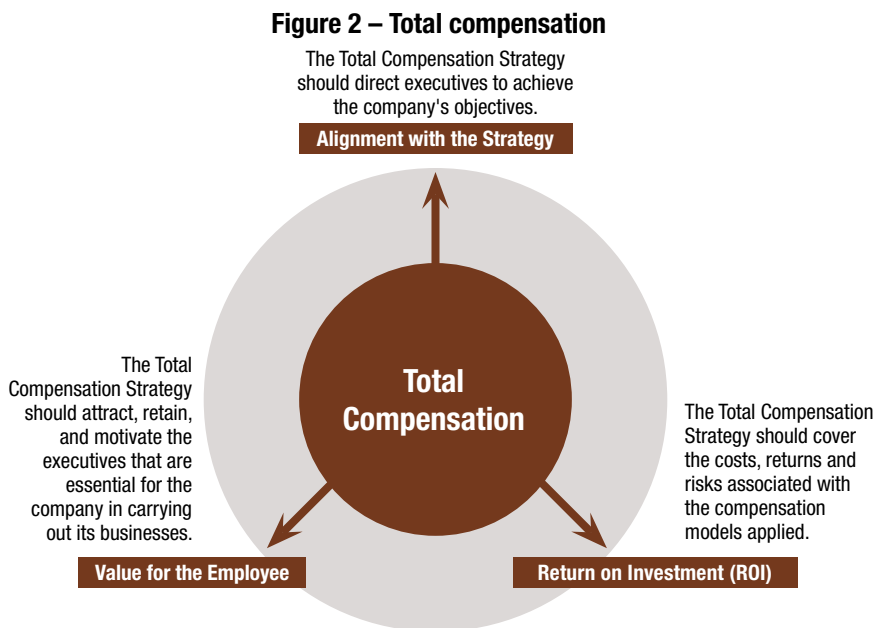
27. Group of companies a given organization uses for comparison purposes, regarding compensation practices. It may include direct and indirect competitors, market leaders (due to good governance practices, people management or compensation), best companies to work for, market makers and entities with which the company competes when recruiting.

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## 4. Total Compensation Strategy

One of the People Committee's main responsibilities is the proposition of the compensation philosophy and the total compensation strategy to be adopted by the company. The latter should include the basic principles that will guide the development of compensation and people management tools.

The correct definition of a compensation philosophy implies finding the perfect balance between the company's strategy, executives' appreciation, market competitiveness and associated costs.

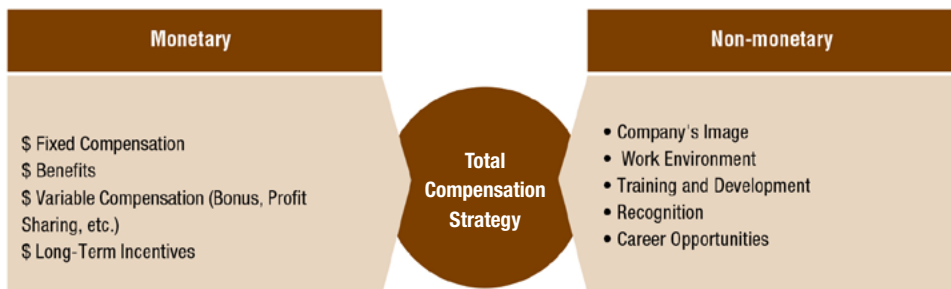


Source: IBGC Human Resources Commission

The objective of an effective total compensation strategy is to achieve a balance between fixed compensation, benefits, and variable compensation, in the short and long term, with the purpose of:

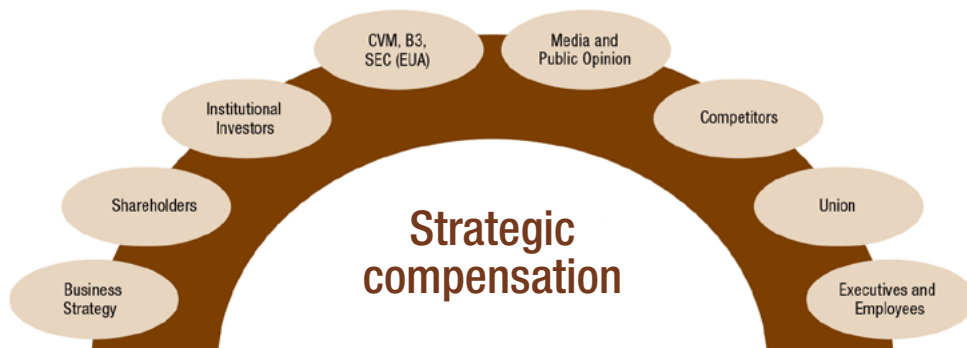
- Ensuring the alignment of the compensation instruments with the company's strategic objectives.
- Balancing the degree of risk involved in compensation – balance between fixed and variable compensation.

The People's Committee is also responsible for managing the elements of non-monetary recognition and reward. The company should give attention to both the monetary and non-monetary elements, to reach a balanced and competitive total compensation policy, thus ensuring a favorable environment that allows sustainable business growth and attraction and retention of talents.

**Figure 3 – Compensation strategy**

*Fuente: Comisión de Recursos Humanos del IBGC*

The implicit challenge in developing an efficient total compensation strategy is to build a sound model – balancing the stakeholders' often conflicting objectives:

**Figure 4 – Strategic Compensation**

*Source: IBGC Human Resources Commission*

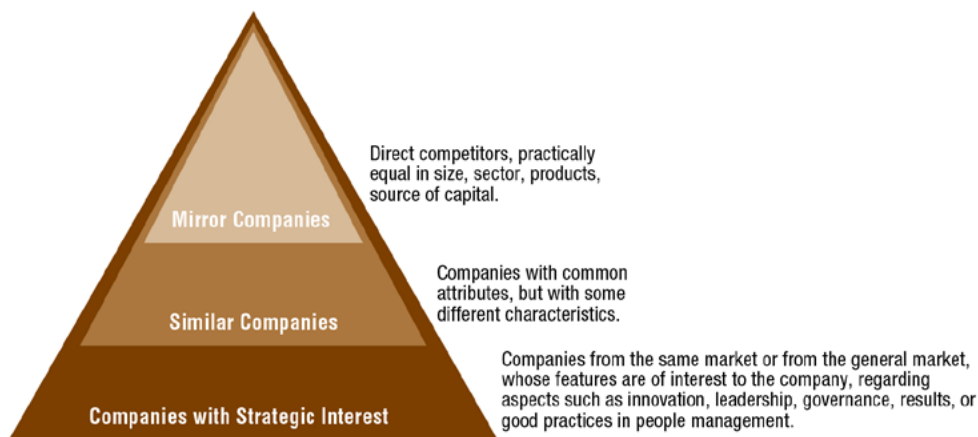
The People Committee should be sure to provide clear answers to at least 5 (five) critical questions related to the total compensation strategy:

1. Is the degree of risk of the compensation programs in line with the company's culture, values, and corporate strategy?
2. Is the total compensation package defined in a consistent and balanced way, in line with the degree of risk considered ideal?
3. Does the company have efficient mechanisms for assessing individual and collective contributions?
4. Are the indicators of the incentive programs results sound and consistent, and in line with the business plan? Do these indicators direct employees to pursue the strategic results defined by the shareholders?
5. Is executive compensation based on clear performance criteria and on market practices?

## 5. Definition of Competitive Market

As for the executive board compensation, it is essential to carefully select the competitive compensation market. The most used criteria for this purpose are:

**Figure 5 – Criteria for compensation competitiveness in the market**



*Source: IBGC Human Resources Commission*

Therefore, the selected competitive market plays a very important role in the evaluation of the level of competitiveness of the total compensation and its components. This enables a good comparative basis, even if considering companies with different business models, other source of capital, size, etc., In reality, in the current business environment, where strategies, structures and markets are constantly changing, it is essential to ensure that the company adopts a total compensation strategy that involves its competitors.

A relevant aspect is that, regarding less developed sectors or companies, particularly national companies, information on the competitive market might be insufficient or hard to obtain. In these cases, competitive market should be considered the group of companies by whom and from whom most professionals are hired. Additionally, external companies specialized in compensation surveys can be hired.

## 6. Definition of Positioning in Relation to the Market

A fundamental aspect when defining the total compensation strategy is associated with the correct definition of positioning in relation to the market. Most companies adopt as their compensation benchmark the average/median of the reference market. Some are in the 3rd market quartile. Others have more precise information:

- Above the market, for key positions or key individuals.
- Market average / median, for positions where there is a high supply of talent.
- Below the market for initial positions, where the company's appeal and reputation ensures attractiveness of good candidates at a lower cost.

This definition, however, should follow a detailed analysis of the current scenario of each company and of the elements that have impact in such decision, as shown in the table below:

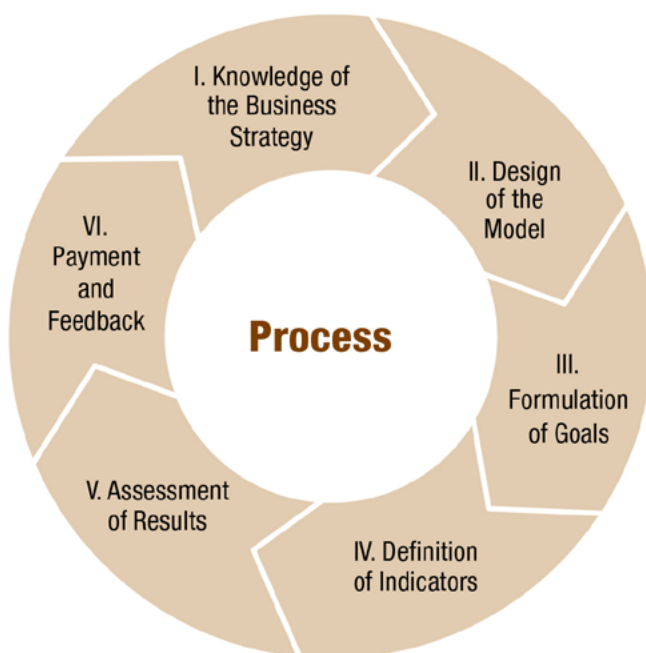
**Figure 6 – Compensation scenarios in relation to the company**

	Abundant	Adequate	Limited	Rare
1. Talent Availability	Abundant	Adequate	Limited	Rare
2. Performance Expectations	Low	Average	High	Exceptionally High
3. Productivity x Market	Low	Average	Above Average	Very High
4. Employee Mobility	Low	Modest	In some cases	Frequent cases
5. Team Structure	Excessive	Adequate	Light	Extremely Light
6. Market Instability	Little or None	Moderate	High	Very high
7. Company's Reputation	Excellence	Respectable	Unknown	Unfavorable
	40° Percentil	50° Percentil	60° Percentil	75° Percentil

Source: Watson Wyatt

## 7. Definition of Annual Variable Compensation Program for Executives

**Figure 7 – Executive evaluation and compensation process**



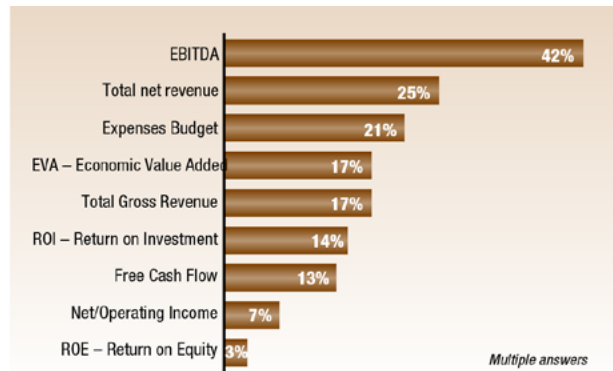
*Source: IBGC Human Resources Commission*

The Board of Directors should be directly involved in defining the premise that will guide the variable compensation program for executives, and should ensure that:

- The objectives and motivations are clear.
- The program is simple, balanced, realistic, plausible, and challenging.
- The program effectively establishes conditions for the alignment of the executives' compensation with the business strategy defined by the Board of Directors;
- The executives' potential compensation is aligned with the strategic premises of total compensation and competitive in relation to the market.

The Board of Directors is also responsible for the final approval of the result indicators that will be used in the variable compensation program for executives. The table below shows the indicators most used in the Brazilian market:



**Chart 1 – Most used result indicators**

*Source: Watson Wyatt*

## 8. Definition of the Long-term Incentive Program

Long-term incentives are variable compensation programs that have the purpose to ensure, besides the results projected by the company, the alignment, retainment, and commitment of executives with a high level of performance in the medium and long terms. Long-term incentives normally have a cycle of three (3) to five (5) years and are usually applied only to senior executives, although they can be extended to all levels.

The three (3) main types of long-term incentive programs are:

- Stock Options.
- Phantom Stocks or Phantom Shares.
- Long-term Bonus (based on the fulfillment of preestablished goals).

There are several reasons for companies to develop long-term incentive programs.

Among them, we highlight:

- Reward and share value adding.
- Align executives and shareholders' interests.
- Promote a long-term vision in the company management.
- Lead executives towards a vision of perpetuation of the business.
- Enable officers a healthy capital gain.
- Enable strategic people to remain at the company.
- Lower the emphasis on fixed income.
- Be competitive in the market.

Once a long-term incentive program is approved, it should be fully aligned with the company's main motivation – whether towards long-term strategic results or executive retention.

Most times, both motivations are present at the same time, although in different intensities:

- In companies where the main motivation is the search for long-term results, the program design should include indicator triggers that condition the prize payment to reach established goals.
- In companies where the main motivation is executive retention, the program design should include prize-delay mechanisms, from time to time, motivating the executive to continue with the company to earn their prize.

Typical issues that must be dealt with in designing a long-term incentive program are:

- Type of shares to be distributed (ON, PN).
- Definition of shares origin (market, treasury, or new issues).
- Dilution (capital % to be distributed long-term).
- Criteria to set the number of shares per professional group eligible.
- Exercise price (initial share value).
- Exercise price adjustment criteria.
- Option term (usually, 10 years).
- Option vesting period / term to exercise the right.
- Additional sale restriction, after exercised an option.
- Stock purchase payment method (cash or financing).
- Compulsory exercise of options.
- Compulsory repurchase of shares by the company.

## 9. Setting the Severance Package for Senior Executives

Senior Executives Severance Packages are used in cases of termination of contract due to low performance, consolidation, acquisition, or restructuring, among others. This is a quite common practice in countries like the United States and England, but still not as common in Brazil.

Usually, these packages are composed by:

- A cash compensation – usually 1 to 2 salaries per year worked.
- Extension of health and life insurance plan – usually for 6 to 12 months.
- Hiring specialized executive outplacement services.

## 10. Directors Compensation

Directors must be properly compensated, considering the market, their qualifications, level of contribution, value added to the organization, and the risks of the activity. However, compensation structures for Board members should be different from those used for management, given the different nature of these two instances of the organization and the fact that the Board of Directors has a fixed term of office.

Companies must have a formal and transparent procedure for approving their compensation and benefit policies for Directors. They must consider the costs and risks involved in these programs and the possible impact on the partner's ownership interests.

The directors' compensation values and policy should be proposed by the Board of Directors and forwarded for approval at the Shareholders' / Partners' Meeting.

Directors and executives shall not engage in any resolution about their own remuneration, thus avoiding conflicts of interest.

Directors' compensation must be disclosed individually, or at least in a separate block from those of the management<sup>28</sup>.

## 11. Fiscal Council Compensation

According to the Corporation Act (Law No. 6404 of 15 December 1976), chapter XIII, article 162:

Paragraph 3: The remuneration of the Fiscal Council members – in addition to the mandatory reimbursement of travel and subsistence expenses necessary to perform the duties – will be established by the general meeting that elects them, and will not be less than ten percent, for each acting member, of that which, on average, is attributed to each Executive Member, not including benefits, representation funds, and profit sharing.

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28. See item 2.24 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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The Civil Code (Law No. 10406 of 10 January 2002), in turn, in chapter IV, section IV, states that:

Art. 1,068. Members of the fiscal council compensation will be agreed on annually by the shareholders' meeting that elects them<sup>29</sup>.

In addition, the IBGC Code of Best Practices of Corporate Governance, in its 4th Edition, published in 2009, states:

5.8 Fiscal Council members should be adequately compensated, considering the experience and skills required to perform their function. They are entitled to reimbursement of any expenses relating to the performance of their function. There should be no variable remuneration for Fiscal Council members. Their pay should be set according to the total remuneration for executives, including amounts received by the executives through different companies in the same group. Fiscal Council remuneration should be disclosed individually, or at least as a separate group from the administrators' remuneration. If there is no disclosure of individual payments to Fiscal Council members, the organization must justify its option in a broad, comprehensive, and transparent manner.

## 12. Summary of CVM Order No. 480, of 07 December 2009

On 07 December 2009, the Brazilian Securities Commission ("CVM") disclosed CVM Order No. 480 which sets forth registration rules for securities issuers admitted in regulated market negotiations, as well as the information regime such issuers are subject to.

CVM order N° 480/09, which came into effect on 01 January 2010, replaces CVM Order No. 202 of 12 June 1993, and applies to all securities issuers admitted to trading in regulated markets in Brazil, including foreign issuers, with the exception only of investment funds, investment clubs, and some others expressly mentioned in the rule, which remain subject to specific CVM regulations.

The Order adopts a template in which the information regarding the issuer is gathered in a single document, regularly updated, called the Reference Form. This new document substantially improves both the quantity and the quality of information made available to investors and the market from time to time, bringing Brazilian rules to standards close to those recommended by international institutions specialized in securities markets. The sections on transactions with related parties, comments from directors, market risks, general meetings and management, and directors' remuneration deserve to be highlighted.

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29. See item 5.8 of the IBGC Code of Best Practices of Corporate Governance, 4th edition.

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In addressing the issue of managers' compensation (Annex 13), the new order deals with:

13. Compensation policy and practice for the board of directors, executives, elected or otherwise, fiscal council, bylaw committees, and audit, risk, financial, and compensation committees.
- 13.2 and 13.3 Fixed and variable compensation recognized in the result of the past three (3) fiscal years and that foreseen for the current fiscal year for the Board of Directors, elected executives and fiscal council.
- 13.4 Share-based compensation plan in the last fiscal year and foreseen for the current fiscal year for the board of directors and elected executives.
- 13.5 Number of shares or quotas directly or indirectly held, in Brazil or abroad, and other securities convertible into shares or quotas, issued by the issuer, its direct or indirect controlling shareholders, companies controlled or under common control for the board of directors, non-executive management and fiscal council;
- 13.6 Share-based remuneration recognized in the result of the last 3 (three) fiscal years and that foreseen for the current fiscal year for the board of directors and elected executives.
- 13.7 Open options at the end of the last fiscal year for the board of directors and elected executives.
- 13.8 Options exercised and shares delivered related to share-based remuneration, in the last 3 (three) fiscal years for the board of directors and elected executives.
- 13.10 Pension plans in force for the board of directors and elected executives.
- 13.11 Individual information for the last 3 (three) fiscal years, within the board of directors, statutory board, and fiscal council. The required information is:
  - value of the highest individual compensation
  - value of the lowest individual compensation
  - average individual compensation
- 13.12 Description of contractual arrangements, insurance policies or other instruments that structure mechanisms for remuneration or damages in the event of removal from office or retirement, indicating the financial consequences for the issuer in relation to the board of directors and elected executives.
- 13.13 Indication of each body total remuneration percentage recognized in the issuer's results referring to the board of directors, elected executives, and fiscal council, which are parties, directly or indirectly, related to the controllers as defined by the accounting rules regulating this matter, in relation to the 3 (three) last fiscal years.

- 13.14 Indication of the amounts recognized in the issuer's income as remuneration for the board of directors, elected executives, fiscal council, grouped by type, for any reason other than the role they occupy, such as commissions and consultancy or advisory services rendered regarding the last 3 (three) fiscal years.
- 13.15 Indication of the amounts recognized in the income of direct or indirect controllers of companies under common control and subsidiaries of the issuer, as remuneration of members of the board of directors, elected executives and fiscal council of the issuer, grouped by type, specifying the title under which such values were attributed to such individuals regarding the last 3 (three) fiscal years.
- 13.16 Other information that the issuer deems relevant.

## 13. Technical Pronouncement CPC 05

The Accounting Pronouncements Committee in its Technical Pronouncement CPC 05 determines that an entity's financial statements contain the necessary disclosures to evidence the possibility that its financial position and results may have been affected by the existence of transactions and balances with related parties.

The following terms are used in this pronouncement with the meanings described below:

**Related party** is the party that is related to the entity:

- a. directly or indirectly through one or more intermediaries, when the party
- b. is a member of the key management personnel of the entity or its parent

**Related party transaction** is the transfer of resources, services, or obligations between related parties, regardless of whether there is an amount allocated to the transaction or not.

**Employees and managers compensation** include all benefits to employees and managers, even benefits paid based on shares and financial instruments. Employee and manager benefits are all forms of compensation paid, payable, or provided by, or on behalf of, the entity in exchange for services rendered to them. This also includes the remuneration paid on behalf of the entity by its parent / investor company. Remuneration includes:

- a. short-term benefits for employees and managers, such as wages, salaries, and social security contributions, paid leave and sick paid leave, profit sharing and bonuses (if payable within twelve months after the end of the year), and non-cash benefits (such as health care, housing, automobiles, and subsidized or free of charge goods or services) for current employees and managers.

- b. post-employment benefits, such as pension plans, other retirement benefits, post-employment life insurance and post-employment health care.
- c. other long-term benefits to employees and managers, including leave for years of service or other types of leave, jubilee or other benefits for work anniversaries, long-term disability benefits and, if not payable in full within twelve months after year-end, profit sharing, bonuses, and future remuneration;
- d. severance benefits; and
- e. share-based remuneration.

**Key management personnel** are people who have authority and responsibility for the planning, direction, and control of the entity's activities, directly or indirectly, including any manager (executive or otherwise) of that entity.

16. The entity should disclose the compensation of key management personnel in total and for each of the following categories:
  - a. employees and managers short-term benefits.
  - b. post-employment benefits.
  - c. other long-term benefits.
  - d. severance benefits; and
  - e. share-based remuneration.
17. If there were transactions between related parties, the entity shall disclose the nature of the relationship between the related parties, as well as information on the existing transactions and the necessary balances to understand the potential effect of this relationship on the financial statements. These disclosure requirements are in addition to those referred to in item 16 to disclose key management personnel remuneration. Disclosures should include, at least:
  - a. transaction amount;
  - b. existing balances and;
    - i. their terms and conditions, including whether they are covered by insurance, and the nature of the compensation to be paid; and
    - ii. information on any guarantees given or received.
  - c. provision for doubtful debts related to the amount of existing balances; and
  - d. expenses recognized during the period regarding bad debts or doubtful debts of related parties.
18. Item 17 disclosure requirements should be made separately for each of the following categories:

- a. controller.
  - b. entities with joint control or significant influence over the entity.
  - c. controlled companies.
  - d. affiliated companies.
  - e. joint ventures in which the entity is an investor.
  - f. key management personnel of the entity or its parent company; and
  - g. other related parties.
19. The classification of amounts payable to, and receivable from, related parties in different categories as required in item 18 is an extension of the disclosure requirements of the standard that deals with the presentation and disclosure of the financial statements. Related party categories are broadened to provide a more comprehensive analysis of balances and transactions with these parties.



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