What We Have Here is a Failure to Communicate
Why Organizations and Investors in the Real Estate Industry Need Better Alignment in their Succession Planning Strategies

Authors:

Annalisa Barrett
Clinical Professor of Finance, University of San Diego School of Business and Founder & CEO, Board Governance Research LLC

Bob Thomas
Portfolio Manager, Global Property Equities Henderson Global Investors, Inc.

Camille Lee, MA
Vice President, Leadership Consulting, Ferguson Partners

Dominic Cottone, MS
Managing Director, Leadership Consulting, Ferguson Partners
Purpose

In a recent study by one of the authors, there is evidence to suggest that official disclosure of an organization’s CEO succession plan may be tied to organizational performance. This finding led to a number of questions for the authors centered around not only the information that can and should be shared between investors and organizations, but also the characteristics of a best-in-class succession plan that is worthy of disclosure to investors. Further, through our professional experiences as consultants, investors and researchers we have noticed that tension between organizations and investors around topics like succession planning chiefly arises from misalignment in communication. A main goal of this article is to help organizations and investors better align with each other’s needs as well as maintain transparency. It also puts forth our observations and recommendations for an effective succession planning process, discusses the benefits and challenges of succession plan disclosure, and offers foundational pillars for the relationship between organizations and investors. Given the public real estate sector’s maturation and growth over the past decade, succession planning is an emergent topic; we have tailored our discussion through that lens.

Introduction: The State of the Union in Real Estate

To quote many a US president, “The state of the union is strong.” And indeed, that is true of the real estate industry. The public real estate sector has matured significantly over the last 16+ years, growing from a market capitalization of approximately $115mm at the beginning of 2000 to just over $800bn today. This level of growth has transformed the industry from a niche sector dominated by family-run companies to an institutional-quality sector. This shift is exemplified in Morgan Stanley Capital International (MSCI) awarding a new Global Industry Classification Standard (GICS) sector classification — the first of any kind since MSCI started the GICS in 1999. Real Estate Investment Trusts (REITs) have also positioned themselves as attractive and stable investment options in today’s market, with public pension and institutional funds representing a large proportion of invested capital. Further, there are now 27 REITs in the S&P 500, another testament to how much REITs have grown in the last two decades and their position as credible investment options. Yet, with this increased prominence comes even greater expectations of best-in-class corporate governance, which has become a prerequisite by many in the investment community. In efforts by both the company and investors to maximize growth and shareholder return, a major challenge that is, and should be, top-of-mind for all is management succession planning to ensure timely, efficient, and effective continuity of organizational leadership.

Management Succession Planning: The Challenge

Succession planning is a challenge, not only for those in the real estate industry, but also any organization. The reason is because to do succession planning well is a hard and daunting task.
It touches multiple stakeholders throughout the business, and the ripple effects of the overall process and decision can have far-reaching impact and consequence upon the organization — to both good and bad effect. But, “a goal without a plan is just a wish.” Many of us have witnessed some of the negative effects poor succession planning can have upon an organization and its investors in a number of worst-case scenarios which could play out much like the following fictional case.

At a large, public company, the founder and CEO was removed due to poor financial judgment and performance that did not match the company’s pace of growth. Without a formal, objective short-term succession plan in place, the company decided to move the Chief Operating Officer into the CEO role. The Board, however, did not have full confidence the COO possessed the necessary capabilities that would be critical for ensuring the strategic success of the business. As a result, the new CEO suffered increasingly poor relationships with the Board. Needless to say, without full cooperation and collaboration between the CEO and the Board, a detailed, long-term succession plan was not started in earnest. This lack of planning ultimately came to a head when the CEO abruptly resigned — leaving behind a hand-picked potential successor without the benefit of careful development to ensure the persons readiness, but also without multiple successor alternatives.

The situation became even more dire when weeks after assuming CEO responsibilities on an interim basis, the heir apparent suffered a significant health crisis that left him unable to continue as interim CEO. Reeling from the unthinkable, the organization appointed the CFO (a newly-appointed and novice executive) into the interim CEO position. Simultaneously, the Board launched an external search for permanent CEO candidates — thus sowing the seeds for factions for and against the new CEO within the organization, on the Board, among customers and within the investor community.

When the Board ultimately moved forward with the internal candidate, the transition was overshadowed by past misalignment between the Board, CEO, investors, and other members of the company’s executive team. Ultimately, this led to increased turnover on the executive team and the Board, a suffering stock price, and uncertainty among investors.

With the above scenario as a guide, here are the most common pitfalls we have observed throughout the succession planning process.

- Not starting early enough
  - When it comes to CEO succession, there is rarely a “ready now” candidate. Once identified, it takes the average internal CEO candidate 3–5 years to develop the knowledge, skills and abilities to be ready to assume CEO responsibilities. And, it takes an external CEO successor 12–18 months to fully learn the organization, its culture, and the industry to be fully effective.
Also, Boards have a fiduciary duty to address major business risks, including the loss of a senior executive. Therefore, the board must act in good faith, with diligence, and in the best interests of the company. To comply with these duties, boards must plan well enough ahead to ensure an effective transition when the time comes.

- Not establishing both a short- and long-term plan

- To safeguard the business, an organization must address and plan for tangible business threats. This includes diligent planning for the unimaginable. A short-term plan is most useful for immediate, unforeseen succession scenarios, like the untimely departure or incapacity of the sitting CEO. And it should work in tandem with a long-term succession plan in which potential successors are identified and developed well enough in advance to assume responsibilities for a planned transition of power that is aligned with the future strategic needs of the business.

- Placing all your eggs in one basket

- Organizations should identify multiple successors, rather than one heir apparent. And, all successors should be identified through a combination of self-selection and rigorous evaluation against a detailed CEO role profile. By establishing a role profile that outlines the functional leadership knowledge, skills and abilities needed in the future (rather than the present CEO) and socializing the profile with interested candidates, potential successors have the ability to opt-in or out of the selection process.

- Not nominating an official decision-making body

- Nearly one third of boards have not established a formal emergency succession plan and what’s more, most boards spend little more than one hour on succession planning each year. However, the board should be an active participant in the overall process via a standing board succession planning committee. Further, by establishing a formal Board committee that owns the decision, the current CEO is able to remain an active player in the development of all potential successors, rather than holding too much decision-making authority.

- Selecting candidates while looking back, rather than forward, to what the organization needs

- This forces the board and leadership to focus on the position, not the person — which can be extremely difficult, especially when so much of the organization’s current culture and values are so deeply wrapped up in the persona of the current CEO.

- Further, the inherent danger in hand-selecting one successor is that there is a basic human tendency to place greater value upon people and things that remind us of
ourselves. Therefore, organizations may find themselves in the position of liking and selecting a CEO successor whom is very much like the current CEO — even though that may not be what the organization needs to ensure its strategic direction.

- Assuming succession planning stops once a successor is chosen

- Development plans need to be established for all potential successors for leadership positions, and actively monitored. For internal successor candidates, monitoring developmental progress may be based upon internal performance data, feedback on one’s performance, style and approach that is collected via multiple stakeholders (e.g., manager, peers, direct reports), and measures of organizational impact over time. Ideally, the current CEO, HR, the Board and other key decision-makers would make successor development a coordinated effort among all parties, rather relying too heavily upon any one stakeholder group.

- And, the succession plan itself is in a constant state of flux. Depending upon developmental progress, business challenges, etc., the needs of the organization and individuals may change, and potential successors may come on and off the list over time.

Succession Planning: Contrasting Perspectives

**Succession Planning: The Investor’s Perspective**

There is no question investors are placing greater importance on succession planning and are seeking information from organizations that may provide a window into its succession strategies. In 2009, the Securities Exchange Commission (SEC) agreed with investors that regarding the importance of CEO succession in particular: “One of the Board’s key functions is to provide for succession planning so that the company is not adversely affected due to a vacancy in leadership. Recent events have underscored the importance of this Board function to the governance of the corporation. We now recognize that CEO succession planning raises a significant policy issue regarding the governance of the corporation that transcends the day-to-day business matter of managing the workforce.”

Investors are placing greater weight upon information pertaining to organizations’ succession planning processes in their investment decisions. Additionally, a recent study published by the Investor Responsibility Research Center and conducted by Board Governance Research found companies that provide more disclosure about CEO succession planning subsequently had more successful CEO transitions. While it cannot be inferred from these findings that companies who provide robust descriptions of the succession plans definitely have successful CEO transitions, the study does show that boards who have dedicated enough time to succession planning in a way that allows them to provide meaningful disclosure to their investors tend to be more successful.
when they are faced with a CEO change. With this in mind, investors seek disclosure of a few fundamental issues: (1) is there a plan in place?; (2) who is accountable?; (3) how often is the plan reviewed?

**Is There a Plan in Place?**

Investors want to know that the organization and the board is carefully thinking about the issue of CEO succession planning. The Council of Institutional Investors (CII), which represents institutional investors with more than $3 trillion in combined assets under management, says that “[t]he board should approve and maintain a detailed CEO succession plan and publically disclose the essential features in the proxy statement.” To be sure, a majority of boards are doing this and it is encouraging to investors that a number of large-cap REITs address succession planning in their public filings. Specifically, 19 of the 27 S&P 500 REITs explicitly discuss the Board’s plans for management succession in the company’s proxy statement. For example, Simon Property Group has a Corporate Governance Principles document prominently on the investor relations section of the company’s website that details succession plans.

But, in the case where the plan is not disclosed publically or perhaps insufficiently, investors are left wondering whether the board and senior management have contingencies in place to address succession scenarios that can have a significant impact upon business performance, and at worst, investors may arrive at erroneous conclusions about the organization’s viability. For example, investors may perceive the lack of a publically disclosed plan as a signal the business is unable to adapt to the sudden death or departure of the current CEO — an unwelcome, but nonetheless a stark reality for many organizations. Also, the lack of a publically disclosed plan may signal additional suspicions among the investor community. For instance, investors may see the lack of public disclosure as an indication that the organization is experiencing poor business performance, challenges between the CEO and Board, or even poor talent management decisions. At worst, it may lead investors to assume the organization is showing ignorance or disregard to talent development, or even perpetuate the idea of the Board as an exclusive, secretive club. BlackRock, a large institutional investor with $4.65 million in assets under management, calls for companies to address this issue by stating that they “expect succession planning to cover both long-term planning consistent with the strategic direction of the company and identified leadership needs over time as well as short-term planning the event of an unanticipated executive departure.”

**Who is Accountable?**

Even if a plan is disclosed, its success is contingent upon establishing a committee that is dedicated specifically to ongoing review of the succession planning process. Indeed, investors want to know whom to go to with questions about the CEO succession planning process, and who is responsible for holding all accountable to a specified decision-making process. And, they are concerned whether the succession plan has a mechanism in place to ensure it has
enough “teeth” to be successfully implemented. Therefore, investors are keen for organizations to explicitly state where accountability for oversight and implementation of the succession plan lies. BlackRock, “encourage[s] the company to explain its executive succession planning process, including where accountability lies within the boardroom for this task.” However, this level of oversight varies widely from company to company. Some indicate full board responsibility, others delegate the issue to the nominating or compensation committees, and still others create an ad-hoc committee during a CEO transition to oversee the implementation of a plan. This variability can signal to investors that succession is viewed as an ancillary measure that is added to an established committee’s original mandate. This can result in various stop-gap measures that are necessary, but not sufficient. For example, a compensation committee that is responsible for succession planning may incorporate succession planning as an objective in executive pay; yet do so as an insignificant weight in the executive’s discretionary pay calculation (e.g., no more than 5% factor in bonus pay calculations). To be sure, we find it encouraging that succession planning is even included as a factor in CEO compensation and do not want to dissuade Boards from doing so. However, as Boards and committees embark on this process, we recommend they incorporate succession planning as a larger factor and/or include it in non-discretionary pay calculations.

How Often is the Plan Reviewed?

A key question in investors’ minds is whether the CEO succession plan is one that is reviewed regularly, rather than a one-off document that sits collecting dust on a shelf. This is a valid concern as directors often note that although they believe CEO succession planning is important, it is often moved to the end of their long list of responsibilities which may seem more urgent or timely. In fact, a recent survey conducted by PwC found that only 48% of directors surveyed, “very much believe that their boards are spending sufficient time on CEO succession.” Further, CalPERS recommends succession planning be, “a routine topic of discussion by the board” (e.g., a standing item on the annual plan).

Succession Planning: The Organization’s Perspective

An emergent challenge for organizations that are acting in good faith and trying to address investor needs is the question of “where to start?” Sometimes an organization delays succession planning because decision-makers do not know where to start, or because they do not know how to broach the conversation. CEO succession is a personal and sensitive topic. Often, boards are reluctant to address succession planning in an effort to avoid offending the current CEO. At the same time, the sitting CEO may not invite the conversation because he or she does not want to give the board the impression they wish to leave the organization. Therefore, while the organization may have every intention of completing a succession process, the public disclosure of a plan must be weighed against the very real perception that such a conversation may impact the Board/CEO dynamic.
Another reason why organizations may find succession planning disclosure difficult is that although increased transparency is beneficial for the investment community, it also carries potentially unintended consequences for the organization’s talent pool. As an extreme illustration, if an organization were to prematurely name a potential successor in the proxy statement, other motivated potential successors may decide to leave the organization. Although this is a reality of any succession decision, organizations may delay public disclosure or make the proxy language intentionally vague as a means to protect their talent.

Many publicly-traded companies have a wide variety of types of investors, ranging from day-traders to parents saving for college to pension funds managing money for thousands of future retirees. Given this, organizations are often faced with the challenging question of “which investor” their financial reporting and other communications should target. A podcast by the Financial Accounting Standards Board (FASB) recognizes the challenge organizations face when there is a great degree of diversity in the investor community. Indeed, when considering just financial reporting issues as an example, one can turn to any combination of accounting analysts, equity analysts, lenders, etc. Therefore, the wide base of investor views is not homogenous. And, because the investor community is not always aligned in its recommendations, other communities that have a stronger and more cohesive message may have greater influence. For example, the CFA Institute acknowledges that public accounting firms tend to have an influential voice in standard setting.

Further, an added layer of complexity comes from the rise in investor skepticism since the economic downturn and its crushing impact upon the real estate industry. For instance, 69% of investors who responded to a survey conducted by the Association of Chartered Certified Accountants report they are more skeptical of information provided by organizations since the financial crisis. Thus, from the organization’s perspective, this places them in a seemingly lose-lose situation. There are calls for greater disclosure and information is examined with greater scrutiny due to a lack of trust by the investor community. In that case, organizations are left wondering if it is possible to ever provide enough information on financial reporting (let alone disclosure regarding succession planning), and importantly, is there a “right” amount of detail to provide that best satisfies investor needs.

Similarly, organizations are awash with recommendations, guidelines, regulations, oversight, and increased investor advocacy. To illustrate, E&Y publishes a 100-page overview document on proxy statement requirements for public companies. To be fair, Board’s plates are full. There are so many investor issues that succession planning seems less urgent and is therefore, easier to set aside. Or if it is robust within the organization, reporting requirements for other matters take greater precedence and as a result, any disclosure about succession planning is non-existent, cursory, or vague.

Moreover, even though succession planning disclosure is an SEC recommendation and good practice, specific SEC reporting guidelines do not exist. Thus, organizations are not required to disclose...
details regarding succession planning in the proxy statement. What’s more, without standardized reporting procedures organizations may be left to guess what information their investors would find most useful. Transparency begets transparency. Therefore, investors must likewise be especially clear in what they require from organizations to help ensure organizations provide needed information. To quote Cool Hand Luke, “what we may have here is a failure to communicate.”

The Failure to Communicate: Building Alignment in the Investor/Organization Relationship

There is a lot of blame-slinging in the wild west of investor/organization relations. Investors ask for too much information and organizations don’t provide enough! The dialogue between the two may look something like this:

**Investors:** We need more oversight and transparency.

**Organizations:** There are so many fires to put out, something has to give.

**Investors:** You don’t tell me what I need to know!

**Organizations:** We think we do and, there are implications associated with telling you too much.

**Investors:** We need to know who is accountable; otherwise we may have cause for activism.

**Organizations:** You don’t know many of the intricacies of my business.

What we’ve observed is likely getting in the way is a misalignment between investors and organizations in their relationship-management. Indeed, what is often forgotten is that each party, organizations and investors alike, are working toward the same goals. Below, we outline key pillars that support mutual trust and transparency between investors and organizations — thus mitigating the risk of miscommunication.

**Pillars: We’re All Working Toward the Same Goals**

Based on much of our research at Ferguson Partners and through regular opportunities to partner with investors and organizations alike, we have identified a few pillars that support the investor/organizational relationship.

**1. Sustainability**

The capacity to endure in times of great change, including the ability to remain nimble, flexible and understanding when there is a perceived environmental threat. This includes:

- A shared understanding of organizational strategy, including goals and objectives and back up plans should there be a change in tides.
○ A clear roadmap for operational excellence, with a focus on simple and streamlined processes and procedures.

○ An organizational structure that makes sense and supports the overall strategy, with a clear definition of what leadership capability is required to achieve it.

○ Talent and performance management functions that are taken seriously and made a priority in the organization.

2. Transparency

A clearly defined way forward, articulated succinctly by the organization and with the opportunity for two-way dialogue and input. In order to establish transparency between organizations and investors, there must be a number of behavioral objectives associated with the engagement, including:

○ An empathic perspective: investors must try and perceive things from the organization’s perspective and vice versa. This includes taking the appropriate actions to mitigate any potential misperceptions as a result of communications.

○ An assumption that both parties are leading with positive intent and want to do right by the business. Regular skepticism of others’ motivations, especially with little data to determine a response, erodes trust over time until it’s irreparable.

○ An opportunity to earn respect through patience and a clear understanding of each other’s needs.

3. Risk Management

A balanced perspective on risk without being too cautious or too careless. To achieve this balance requires a greater understanding for the risk tolerance of organizational leaders and the risk requirements of investors. This includes a deeper knowledge of leaders and their ability to:

○ Manage uncertainty while still maintaining a central focus on the organizational strategy.

○ Provide sound rationale for decision making and incorporating feedback from other alternatives.

○ Identify and select the criteria necessary to make informed decisions leveraging an understanding of investor concerns and considerations.
4. Legacy

Organizational reputation and legacy is an important aspect of the relationship. While many leaders and investors alike are focused on short-term gains, the most successful organizations rely on the impact of their legacy to help transform the future. This means:

- All parties understand organizational historical context, recognize the impact of decisions in the past and continue to focus on long-term strategy.
- Leaders and investors are equally focused on the brand of the organization, as publicly aired frustrations always lead to a longer-term brand fallout and PR nightmare for any organization.
- Individuals in family-owned businesses must be objective in their views of succession, especially when very close, personal relationships may blind their ability to judge talent and business capability effectively.

5. Timing

A structured, ongoing cadence for reviewing and maintaining shared information is a critical aspect of the investor/organization relationship. Although many organizations and investors focus upon the annual proxy statement, regular information sharing via formal and informal means is most effective. This means:

- Regular and perhaps over-communication between both parties via forums, best-practices in investor relations, and mechanisms for feedback (from both parties).
- A dedicated board committee for major investor needs, not only those required by the SEC. This ensures the committee’s time is not unnecessarily spread across too many committee goals and projects. This includes a dedicated committee with succession planning as its mandate, rather than incorporating succession planning as a secondary goal of an already established committee (e.g., nominating committee, compensation committee).

Conclusion

In thinking about your own investor/organizational relationships, we recommend stepping back to reflect upon the other party’s perspective. Ask yourself the following questions: Have I been extremely clear in the information I share/expect? Will my request or shared information promote greater adoption of the pillars by both parties? What alternate interpretations/explanations might exist for either party’s behavior? Have I thought through each perspective on issues of Sustainability, Transparency, Risk Management, Legacy, and/or Timing? Doing so will ensure the most effective investor/organization relationship, whether it be for succession planning purposes, or any other business issue.
About FPL Advisory Group

FPL Advisory Group is a global professional services firm that specializes in providing executive recruitment and leadership, compensation, and management consulting solutions to the real estate and a select group of related industries. Our committed senior professionals bring a wealth of expertise and category-specific knowledge to leaders across the real estate, infrastructure, hospitality and leisure, and healthcare services sectors.

Comprised of three businesses that work together, FPL Advisory Group offers solutions and services across the entire business life cycle:

**Ferguson Partners:** With an emphasis on the right executive fit, Ferguson Partners offers services in executive recruitment, as well as leadership consulting.

**FPL Associates:** Focusing on compensation, FPL Associates assists with the assessment, design and implementation of compensation programs.

**FPL Consulting:** Covering a wide array of business needs, FPL Consulting partners with clients to develop strategies and structures to drive competitive performance.

<table>
<thead>
<tr>
<th>Ferguson Partners</th>
<th>FPL Associates</th>
<th>FPL Consulting</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Executive Search</strong></td>
<td><strong>Leadership Consulting</strong></td>
<td><strong>Management Consulting</strong></td>
</tr>
<tr>
<td>Board/Trustee Recruitment</td>
<td>Succession Planning</td>
<td>Strategic Planning</td>
</tr>
<tr>
<td>Board Assessment</td>
<td>Assessment for Selection or Development</td>
<td>Organizational Design</td>
</tr>
<tr>
<td>Chairmen/CEOs/Presidents</td>
<td>Executive Coaching</td>
<td>Corporate Finance</td>
</tr>
<tr>
<td>Senior Management/Corporate Officers</td>
<td>Team Effectiveness</td>
<td>Specialized Research</td>
</tr>
<tr>
<td><strong>Compensation Consulting</strong></td>
<td><strong>Benchmarking</strong></td>
<td><strong>Contractual &amp; Policy Arrangements</strong></td>
</tr>
<tr>
<td><strong>Program Design</strong></td>
<td><strong>Surveys</strong></td>
<td><strong>Surveys</strong></td>
</tr>
<tr>
<td><strong>Assessments</strong></td>
<td><strong>Surveys</strong></td>
<td><strong>Surveys</strong></td>
</tr>
</tbody>
</table>

Our Industry Practices

**Real Estate**
Private Equity/Real Estate Investment Managers, Public (REITs) & Private Owners/Developers, Property Services (Brokerage) Firms, Commercial Mortgage Investment/Finance, Residential Mortgage Investment/Finance, Homebuilders, Corporate Real Estate

**Hospitality & Leisure**
Lodging (Brands/Owners), Gaming Resorts & Casinos, Restaurants, Sports & Recreation, Amusement Parks & Attractions

**Healthcare**
Owners/Investors/Operators/Financiers of Seniors Housing, Hospitals, Health Care Service Providers

**Infrastructure, Engineering & Construction**
Infrastructure Investing: Transport, Energy, Social Infrastructure; Construction & Engineering; Project Management

© 2016 FPL Advisory Group. The Ferguson Partners recruitment practice consists of five affiliated entities serving FPL’s clients around the world: Ferguson Partners Ltd. headquartered in Chicago with other locations in New York and San Francisco, Ferguson Partners Canada Co. in Toronto, Ferguson Partners Europe Ltd. headquartered in London with a Japan branch located in Tokyo. Ferguson Partners Hong Kong Ltd. in Hong Kong, and Ferguson Partners Singapore Pte. Ltd. in Singapore. Ferguson Partners Europe Ltd. is registered in England and Wales, No. 4232444. Registered Office: 100 New Bridge Street, London, EC2V 6JA. Ferguson Partners Singapore Pte. Ltd. is registered in Singapore, Business Registration No. (UEN) 201215619H, Employment Agency License No. 1256233. FPL Associates L.P., the entity which provides consulting services to FPL’s clients, is headquartered in Chicago.