



Building a spin-off board: Are you ready?

A new era of corporate splits, spins, and separations raises the stakes on making a bad board appointment. Here's how thoughtful parent companies avoid them when turning one board into two.

Spin-offs, split-offs, and equity carveouts are all among the ways companies are reshaping themselves to meet new consumer demands and changing stakeholder expectations. Compared with other types of restructurings, these put particular focus on building a board for the new entity and reconfiguring the parent's own board all at the same time and under great time pressure. Filling one board seat is difficult enough. Filling 10 or more is downright daunting. The complexities multiply and so do the risks of making mistakes—mistakes that a company and its stakeholders may not be given the opportunity to fix. We have found that companies can avoid the manifold pitfalls of the challenge, create the optimal board for taking the new company forward, and maintain the strength of the parent company board by following four guidelines: develop the ideal board composition for the new company's purpose and strategy; begin recruiting new directors as soon as possible; establish a structured timeline and project plan; and shape the board culture with intention.

The context of spin-offs

After growing through the early 2010s, the number of public company spin-offs per year has tapered slightly, but they are still fairly common. In many cases, leaders of diversified companies continue to see separations as an opportunity to create more value by allowing management to focus on its core business, monetize undervalued assets, and separate businesses that are out of phase with each other and drag down the stock price.

More vocal shareholders, especially activist investors, are also increasingly pushing for spin-offs. Following the pandemic-related downturn in activist activity of mid-2020, the first quarter of 2021 saw a second consecutive quarter of elevated global activity—53 new campaigns were initiated, which is in line with first-quarter 2020 levels.¹ Major recent calls to action include Barington Capital Group's pressure on L Brands to separate Victoria's Secret and Bath & Body Works,² Elliot Management and Starboard Value LP calling on eBay to spin off or sell StubHub and its classified ads platform,³ and Honeywell's planned spin-offs of its home and ADI global distribution businesses after pressure from Third Point.⁴

Building a new board and reshaping the old one present formidable challenges: the parent company must determine a comprehensive, strategic profile of the board-to-be as well as its own new shape, identify non-conflicting candidates for each seat, successfully recruit directors, and begin to shape new board cultures that support the new strategies, all within the 12 months or less that typically elapse between the announcement of a separation and its completion. Often enough, boards must begin this work even before they have made the final decision to spin out, meaning that they also have to work without public disclosure.

Develop the ideal board composition for the new company's purpose and strategy

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A board seeking to fill a vacancy or two as part of its regular refreshment process need only fit the expertise, backgrounds, and styles of a few new members into the already defined skills and culture of the current board. There are, in effect, only a few variables. But when the capabilities, knowledge, and styles of a full board must be identified and made to fit into a coherent whole, multiple variables must be worked out almost simultaneously. Boards should approach this task with the understanding that they are developing an entire ecosystem, one in which each decision will affect many others. They must also not forget that any members of the parent board who move to the new board are necessarily changing the dynamics of the existing board.

Before embarking on multiple searches, the board should therefore determine the mix of competencies that both the new board and the parent board will need following the split. The exercise should answer the following questions:

- What is each organization's purpose, and what is the role of the board in fulfilling it?
- What are the key strategic imperatives for both companies over the next three to five years?
- What are top priorities for each board?
- Based on those strategic imperatives and top priorities, what mix of capabilities, areas of expertise, and backgrounds will each board need in its directors to assist the CEO and management team in addressing these opportunities and challenges?

¹ Lazard, "Lazard's Quarterly Review of Shareholder Activism – Q1 2021," April 14, 2021, [lazard.com](https://www.lazard.com/activism/).

² Cara Lombardo, "L Brands Faces Pressure to Separate Victoria's Secret, Bath & Body Works" *Wall Street Journal*, March 15, 2019, [wsj.com](https://www.wsj.com).

³ Cara Lombardo and Laura Stevens, "Starboard, Elliott Management Call on eBay to Shed StubHub, Classifieds," *Wall Street Journal*, January 22, 2019, [wsj.com](https://www.wsj.com).

⁴ *Spin-Off Guide*, Wachtell, Lipton, Rosen & Katz, May 2021, corpgov.law.harvard.edu.

Both the spin-off and parent company boards should have clear and defined term limits and not assume that directors will automatically serve until retirement age. Such moves can help with better planning and ensure a good balance of seniority on the board over time.

In this context, a detailed review of the approach the current parent company board takes to refreshment will be a helpful starting point for many. Spin-offs can create an opportunity to make major changes without the opposition they might otherwise face. Boards, especially the chairs of nominating and governance committees, should start by taking a step back to assess whether their current size, term length, term or age limits, and current cadence of refreshment are still appropriate. This should be done through the lens of the company strategy post-spin, shareholder expectations for sustainability and diversity, and the current global political environment. Some parent company boards may find that they will need to temporarily expand their size to ensure their ability to attract the directors they most want, particularly if the deal takes some time to finalize. Both the spin-off and parent company boards should have clear and defined term limits and not assume that directors will automatically serve until retirement age, for example. Such moves can help with better planning and ensure a good balance of seniority on the board over time.^{5, 6}

For the spin-off board, boards should treat the competencies and qualifications that emerge as a portfolio that can be satisfied in a variety of ways, but that in the aggregate represent the ideal mix. While seeking that mix, boards must not forget both the need for traditional expertise, such as someone qualified to lead the audit committee, and newer expertise, such as cybersecurity or sustainability expertise. As societal expectations of corporate social responsibility and accountability continue to evolve, another area of expertise that boards may find value is that of nonprofit executives. Due to the nature of the sector, these executives are often more comfortable navigating the current sociopolitical climate as well as working with activists.⁷

Boards will also need to consider diversity in all its forms across all of the roles and ensure both boards have a mix that meets strategic needs and stakeholder expectations. An example of what such a matrix can look like is shown on page 4.



5 Alice Breeden, Theodore Dysart, and David Hui, "Building the foundation for better board refreshment," Heidrick & Struggles, on heidrick.com.

6 Bonnie Gwin and Jeffrey Sanders, "Board succession 2020: Three steps toward long-term effectiveness," Heidrick & Struggles, on heidrick.com.

7 J.J. Cutler and Jackie Zavitz, "Nonprofit expertise on boards," Heidrick & Struggles, on heidrick.com.

Getting tactical: Map skills to candidates using a planning matrix

Hypothetical example

Existing board members New recruits

	Parent company		Spin-off	
Desired criteria				
Sitting or recently retired CEO	Parent company board members		Parent company board members	Retail CEO Tech CEO
Qualified financial expert	Parent company board member	Audit and risk executive	Parent company board member	Former CEO Tech CFO
Growth markets experience	Parent company board members			Chief data officer, large auto manufacturer Chief analytics officer, global software company
Cybersecurity expertise		Cybersecurity executive Former cybersecurity director, government agency		Chief information security officer, global financial company
Industry expertise	Former board member from a company in the same industry			Executives with operating expertise in the spin-off industry
Reflecting the customer base, including diversity		Executives at companies in our largest non-US markets	Parent company board member with the most expertise in the spin-off demographic	

For example, a CEO who is also a former CFO and has extensive experience globally might satisfy several criteria at once: general management experience, financial expertise, and knowledge of emerging markets. Meanwhile, another candidate might bring regulatory experience and knowledge of technology that will be critical for the spin-off's success. The competencies of parent company directors who are moving to the new board will also figure into solving the overall equation.

Begin recruiting new directors as soon as possible

The lead time for recruiting even a single director can be six months to a year, or more. In our experience, companies that conduct successful, orderly recruitment of new directors begin the process almost as soon as the company announces a split or spin-off. Some benefit from starting to recruit even before a deal is announced. Working with less transparency can make recruitment more difficult, but companies such as one international consumer products company have found that having a list and having made initial contact with their most desired candidates allowed them to fill the spin-off board much more quickly than is usually the case.

Whatever the specific timeline, a parent company board should not sacrifice quality for the sake of speed. We have seen numerous instances where poor process has meant that boards fill spin-off seats hastily, regardless of whether the appointees possess the right skills or the new board will have the right dynamics to be effective. While a well-established board may be able to manage around an ineffective or ill-suited member, a spin-off company at the crucial moment of its launch cannot afford the error of even one such member, much less several.

For example, a parent company board that waited many months before starting the recruiting process wound up with a spin-off board of mostly white males, all with similar backgrounds. The spin-off thus began life with a problem of public perception and, more important, a board deprived of the business benefits of a variety of experiences as well as the diversity of thinking that comes from gender and racial and ethnic diversity.

In another case, a parent company's failure to promptly begin recruiting resulted in a spin-off board without a full complement of members. Directors on the new board were spread thinly on committees and spent much valuable time searching for additional members to fill out the board—time that could have been better spent getting the new company off to a fast start.

Our *Board Monitor US 2021* report also underscored that many boards are showing a long-standing trend toward new directors with experience other than CEO or CFO roles, including P&L leaders, the military, government, and academia.

One crucial step for many boards will be expanding their networks beyond the traditional sources of directors, to find people with new areas of expertise—for example, executives with experience in the specific markets the spin-off is addressing. Heidrick & Struggles' most recent Board Monitor report on the new directors added to Fortune 500 boards shows that boards were particularly seeking deep industry operational expertise to cope with 2020's operational challenges. An equal need for deep dive expertise may be necessary for spin-offs.⁸ Our *Board Monitor US 2021* report also underscored that many boards are reaching out in other ways, showing a long-standing trend toward new directors with experience other than CEO or CFO roles, including P&L leaders, the military, government, and academia.

Establish a structured timeline and project plan

The high stakes and short timing reinforce the importance of having a clear process for building boards in this situation, which involves naming a small set of decision makers, developing a clear understanding of the decision-making process that includes a commitment to thorough vetting, and a clear communications plans for the rest of the board and for candidates.

A small set of decision makers: Though the full board will make the final decisions on appointments, the many prior decisions are best handled by a small group, whether the nominating and governance committee or a special search committee designated by the board (the group should include the CEOs of the parent company and the new company). This helps ensure speed and efficiency in managing the complex series of decisions required, including which candidates to consider, interview, vet, and recommend. In the absence of a small group with clear authority to conduct the initial screening, we have seen the process bogged down in conflicting advice from many sources, resulting in an unmanageable number of candidates and a potentially damaging delay.

⁸ *Board Monitor US 2021*, Heidrick & Struggles, on heidrick.com.

A crisp articulation of the decision-making process: Who will meet the candidates? Who has veto power? What role will the existing and new CEOs play? Which tradeoffs is the board willing to make, and which capabilities or areas of expertise are non-negotiable? Because there are so many moving parts, all of these questions should be answered at the outset and made visible to everyone involved. When this doesn't happen, we have seen boards become misaligned, which delays progress, can put candidates off, and puts the spin-off at risk of launching with an incomplete board.

Online tools listing each step and the people involved can be very helpful in ensuring everyone understands the process. One step in the process we have found to be particularly important is having all of the members of the small group directing the process meet all of the candidates who emerge from the initial screening. That approach reduces the possibility of a poor choice and produces the consensus necessary to keep the process moving forward.

Part of the decision-making process must be referencing and a third-party reference check, in addition to the normal interviews and assessments. Boards that forgo these and simply recruit people with outstanding resumes or well-known names can face consequences from the embarrassing to the disastrous.

No shortcuts: Part of the decision-making process must be referencing and a third-party reference check, in addition to the normal interviews and assessments. Boards that forgo these and simply recruit people with outstanding resumes or well-known names can face consequences from the embarrassing to the disastrous. In one instance, a high-profile CEO was appointed to the board of a spin-off company that too closely resembled the company he still served as chief executive. To avoid conflicts of interest, he frequently had to recuse himself from board discussions—so frequently, in fact, that he resigned his seat only a few months after the launch of the spin-off. In another case, a board that neglected to do a background check found shortly after making an appointment that the new director was facing a Wells notice from the SEC.

Therefore, no matter how good a candidate looks on paper or in the press, boards should ensure that each is interviewed face-to-face by the decision makers and thoroughly referenced (formally and informally). Finally, we recommend that the board enlist a third party to conduct a thorough background check on each candidate's legal, financial, work, and education history.

A commitment to responsive communications: Regular communication within the decision-making group is key. Setting up a cadence at the beginning ensures quick, responsive interactions. Issues are quickly dealt with. Many boards find that centralizing information in a single digital tool ensures that all can feel comfortable that they have the information they need, when they need it.

On the candidate side, interviews should take place as soon as possible after the candidate has been contacted and the initial screening conducted. The small group should designate a specific person on the search team to respond immediately to queries and communications from candidates; few things sour potential candidates more than long lapses of silence after they have expressed interest in a board seat. This is particularly important in cases where the deal is not yet finalized or announced, and some communications with people not on the current board are necessarily more opaque than ideal.

Intentionally shape board culture

The dynamics and culture of a board can make all the difference between an effective board and a dysfunctional one. In addition to taking into account how the capabilities and areas of expertise of director candidates fit together, boards should also assess how candidates for the spin-off board impact its desired culture and how candidates for the parent board fit with the culture it will need to shape for the new strategy and organizational purpose. One common reason for a spin-off, for example, is to give a high-growth division room to run outside the legacy organization. The board of such a company will require very different dynamics than that of either the current or new parent company board.

Other elements of board dynamics that are equally important to ensuring they work as cohesive, inclusive teams are alignment on the company's purpose and the purpose of the board in supporting it; making decisions transparently, as a full board; and having a truly inclusive board culture.⁹ At every level, including the board, inclusion—trusting others and feeling trusted and being able to collaborate freely—is central to a productive culture.¹⁰ In the context of a spin-off board, the chair will have to take particular responsibility for building this kind of culture from the start, by ensuring, for example, that all members meet each other, understand the value each brings to the board, and is heard in meetings.

Ensuring that a spin-off outperforms the market

Spin-offs often perform well because a separate entity tends to be more efficient in its capital investment decisions, according to research from Wharton.¹¹ Over the past decades, an index of spin-offs maintained by S&P Dow Jones Indices had an annual total return of 15.25% through the end of March 2021, compared with 11.6% with the S&P 500.¹²

While the success of the clear winners stems from many factors—operational, strategic, and commercial—we know that high-performing boards play a significant role in helping launch sustained success for all companies, including spin-offs. The roots of that success lie in the care with which companies approach their board-building responsibilities.

9 Alice Breeden and Richard Jolly, "Building better board dynamics," Heidrick & Struggles, on heidrick.com.

10 Larry Senn and Jim Hart, *Winning Teams, Winning Cultures*, 2nd ed., Huntington Beach, CA: Senn Delaney, 2010.

11 "How Activist Investor-led Divesting Pushes Up Valuations: An interview with Emilie Feldman," Wharton School of Business, knowledge.wharton.upenn.edu.

12 Charley Grant, "To Spin or Not to Spin? Disposals Create Fortunes and Headaches," *Wall Street Journal*, April 2, 2021, [wsj.com](https://www.wsj.com).

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CEO & Board Practice

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We pride ourselves on being our clients' most trusted advisor and offer an integrated suite of services to help manage these challenges and their leadership assets. This ranges from the acquisition of talent through executive search to providing counsel in areas that include succession planning, executive and board assessment, and board effectiveness reviews.

Our CEO & Board Practice leverages our most accomplished search and leadership consulting professionals globally who understand the ever-transforming nature of leadership. This expertise, combined with in-depth industry, sector, and regional knowledge; differentiated research capabilities; and intellectual capital, enables us to provide sound global coverage for our clients.

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