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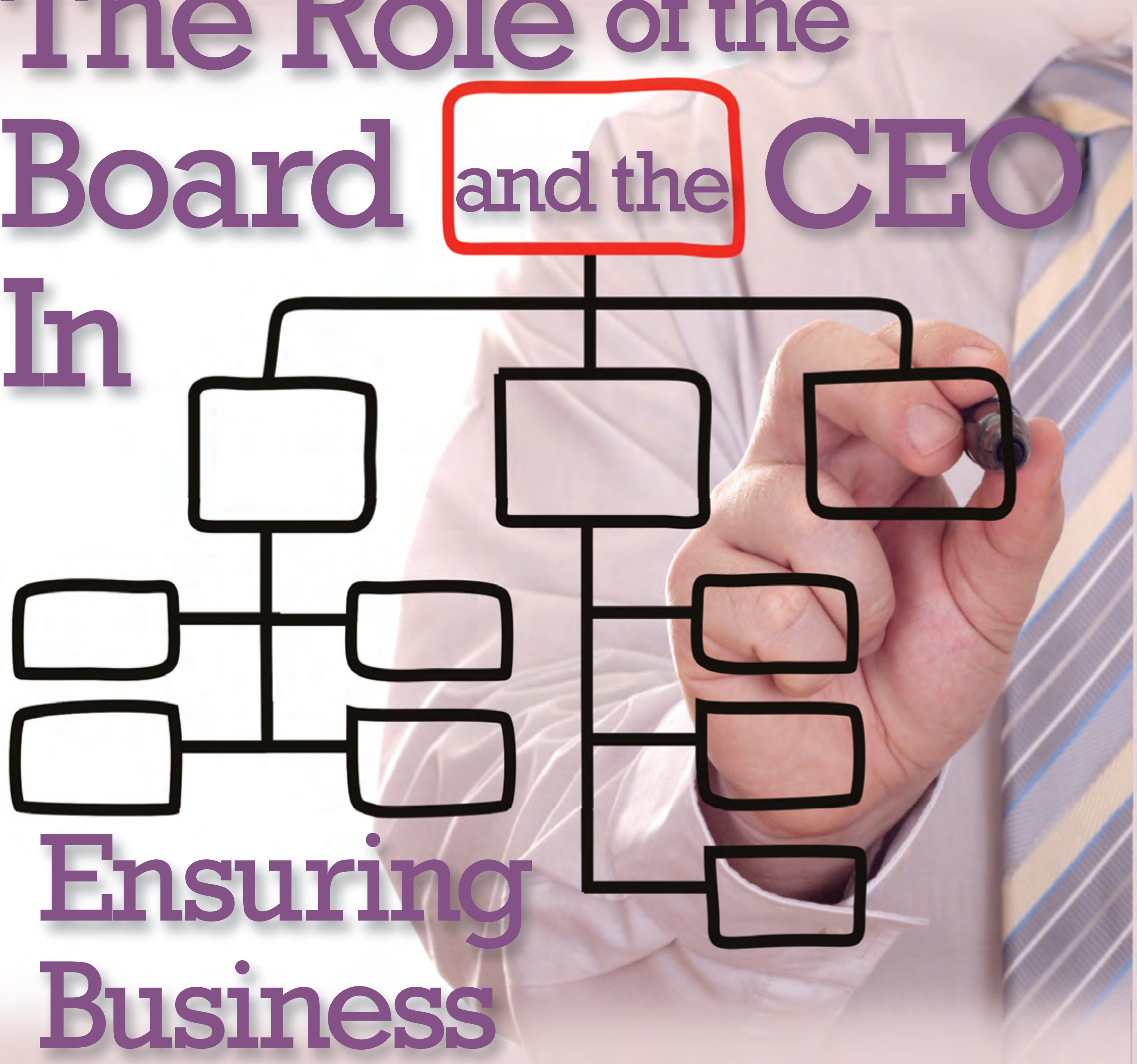
The Role of the Board and the CEO In Ensuring Business Continuity



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SUCCESSION

By

Robert Conlon and

Richard V. Smith

The dated and dangerous "hit-by-a-bus" succession plan is far more common than many CEOs or boards of directors care to admit, but succession management is receiving renewed focus, especially at publicly traded companies.

Asked about his succession plan, the CEO of a major U.S. corporation recently responded that he carries in his pocket a paper with the name of his replacement, should he be unable to continue. Though not the most methodical succession plan, this dated and dangerous "hit-by-a-bus" approach is far more common than many CEOs and boards of directors would care to admit.

But succession management — the practice of carefully identifying and selecting talent to succeed incumbents in a company's critical roles — is receiving renewed focus, especially at publicly traded companies. Activist shareholders want to know how the organization will change direction when turnover occurs and institutional investors need to assess the thoroughness of succession management as a criterion for investment decisions.

Moreover, internal stakeholders want to be assured that their leadership is doing more than worst-case disaster planning. Even governmental entities need to know that their investments are protected from a leadership vacuum.

The importance such succession planning is receiving is evidenced by the Connecticut State Treasurer, the principal fiduciary of the $22.7-billion Connecticut Retirement Plans and Trust (CRPTF). CRPTF announced it had filed shareholder proposals at 12 major corporations related to tying CEO pay and renewing a director's board seat to having a satisfactory succession management plan in place.

Planning Not Just for the Top Spot

Effective succession management is much more than simply having a slate of candidates to replace the CEO. It requires ensuring that the organization has the depth and breadth of talent needed to fulfill its most critical objectives.

Today's increased scrutiny on succession management creates a significant opportunity to transform the process into an activity that can create shareholder value. While succession management in most organizations may have evolved beyond a piece of paper in the CEO's pocket, it still needs significant enhancements to become a strategic advantage.

The impact of unplanned succession can be significant from an economic, operational and cultural perspective. In the absence of a real succession plan, a candidate often emerges because of a perception that he or she is viewed favorably, without a rigorous analysis to determine whether his or her strengths align with the demands of a larger role.

Although succession management has typically been used for upper management, a growing number of organizations are finding that it should also be applied to the company's most strategic and critical roles, no matter where they may fall in the hierarchy.

Consider, for example, a materials scientist who has designed the proprietary manufacturing techniques that give a company a significant competitive advantage over its competitors. Or, a customer relationship manager entrusted with an organization's largest accounts. A departure that leaves either of these roles unfilled, or filled by individuals lacking the necessary experience and capabilities, could do significant damage to the organization's performance.

Companies should have three levels of succession management to ensure a strong pipeline of talent for the most critical roles:

- **Level 1**: The CEO;
- **Level 2**: The senior management team; and
- **Level 3**: Critical roles, based on long-term strategic and economic value to the organization.

To determine what critical roles warrant a succession plan, organizations should segment their workforce according to the roles that most directly drive strategic capabilities.

While several alternatives exist, one suggested methodology is to use a survey to determine strategic linkage combined with very specific criteria for what constitutes a strategic role. In many cases, these criteria include value creation, difficulty in finding replacement talent and time required to reach full proficiency.

The Role of the Board

Given the economic, operational and potential cultural implications of unplanned departures and the risks associated with having to bring in external talent, corporate boards need to make succession management one of their most critical duties.

While a large percentage of directors believe in the importance of a succession plan, most organizations have nothing more than an emergency interim plan, which can be extremely disruptive. Good governance dictates that leadership succession is a priority year in and year out.

The board — or its nomination, compensation or selection committee — must be active stewards of CEO and C-suite succession management, involved in all aspects of the process. This includes assessing potential talent, mitigating risk, making the CEO accountable for executing succession management and planning the development of critical successors.

The board's fingerprints should be all over the organization's leadership development efforts so directors have personal experience with high-potential candidates. In most organizations, this will require a major increase in the level of time and attention the board pays to the process as it shifts from a "checklist" to a "hands-on" methodology.

Board effectiveness in succession management remains low, suggests one current study on CEO succession planning. It found that boards, on average, spend only two hours a year discussing their organization's succession management. Additionally, only half have a written description of the CEO role.

The recent great recession may have caused boards to place succession even more on the back burner while they concentrate on urgent operational imperatives. As the economic crisis subsides and organizations begin to refocus on long-term business success and continuity, it is time for boards to reenergize their succession management efforts.

Boards that are successful in completing their role in the succession process exhibit two key characteristics:

- They have learned how to make decisions objectively. The nature of interpersonal relationships and the proclivity of board members to view leadership behaviors through a personal lens can create strong interpersonal dynamics within the board. As a result, some boards make succession decisions based on personal perceptions of an individual's leadership behavior and results.
- They have a transparent and well-defined succession process. In many organizations, succession management is poorly defined in terms of process steps, ownership and decision rights. A succession management process that is not objective, transparent and robust can be derailed easily, which could result in a poor outcome.

Rigorous succession management processes and tools can bring objectivity and validity to an inherently subjective process.

The Role of the CEO

The company's CEO needs to be challenged to think beyond a strictly hierarchical view of succession in order to critically assess talent-related business risks, regardless of where they may be in the organization. The CEO should be the steward of talent for at least one and sometimes two layers below the senior management team to ensure the organization has the depth and breadth of talent needed for these positions.

Although the board may have input on succession decisions, ultimately the key decisions and selections should be made by the CEO.

This is not to say the CEO should act alone. He or she should hold the organization's senior leaders accountable for conducting a strategic workforce planning activity that will identify the company's most critical and strategic talent areas. Additionally, Human Resources often plays a facilitative role in this process as well as in the identification of critical roles that should be included.

The sitting CEO may participate in the CEO succession management process by nominating candidates from his or her management team and providing input on the fit, readiness and performance of the candidates. But he or she should maintain no more than a consultative role in making this decision.

Managing the Process: Six Steps

Six key steps have proven valuable in managing succession at all three levels of the organization (CEO, senior management team and other critical roles):

■ **Define the role requirements.** Even the most sophisticated succession management process can fall flat without agreed-upon criteria for success in the targeted roles. Role requirements should be centered around four components: Key accountabilities and responsibilities, performance metrics, competencies and critical experience sets.

■ **Assess the candidates and provide them with feedback and coaching.** A combination of assessment methods and techniques will yield the most reliable data needed to inform the succession process. These include: Historical performance feedback, 360-degree behaviorally based interviews and an objective 360-degree survey-based instrument that focuses on success factors essential to leadership and management roles.

All participants should be given

their data and participate in one-on-one sessions with an assessor to understand their results and the implications in terms of advancing in the process. Participants who are viable candidates should receive coaching to close any identified gaps.

■ **Measure the progress of internal candidates.** If there is a defined "end date" for a planned succession event, organizations should reassess the top internal candidates for the role based on observations collected throughout the coaching sessions (which should last about six months).

If necessary, conduct additional behaviorally based interviews with a sample of managers, key direct reports and relevant business stakeholders to determine candidate fit, readiness and progress against development opportunities.

■ **Generate an external candidate pool (if needed).** Sometimes the internal assessment and coaching process reveals that there is no viable internal candidate. If so, external candidates will have to be assessed just as thoroughly as internal candidates are. (See the sidebar to the right, *Sourcing Successors Can Make a Difference*.)

■ **Reassess candidates and make a selection.** An effective final hurdle for the top candidates is a presentation to key stakeholders on how they would address a strategic business issue or challenge that is relevant to the role.

This presentation can provide an opportunity to evaluate an external candidate against an internal candidate and see how they interact with the organization's key stakeholders. This step often makes it apparent who should get the job.

■ **Provide leadership development and conduct talent reviews.** Ongoing talent reviews and calibration are the backbone of succession management. Talent reviews should periodically assess the depth and breadth of the talent currently in critical roles and the feeder pools of talent into these roles. This process will enable organizations to identify any talent gaps and formulate plans (e.g., training and development strategies).

Sourcing Successors Can Make a Difference

While it is certainly clear that bringing in the right skills and experiences — whether from outside or within the organization — is the most critical component of making a hiring decision, it is also becoming apparent that investors care about the source of the talent.

Recent research into nearly 300 CEO successions in Standard and Poor's 500 (S&P 500) organizations over the past 10 years shows a demonstrable difference in total shareholder return (TSR) based on relative historical financial performance versus the source of the successor (internal versus external).

The table below shows organizations that have been performing well may be better off hiring from within, while those that are struggling show better TSR when bringing in an outside successor. While this may seem intuitive, few organizations consciously consider historical shareholder performance in making succession decisions — most view internal and external candidates as relatively equal, with preference generally favoring the internal candidate if all role requirement considerations are equal.

Average Post-Succession Three-Year TSR Relative to the S&P 500

TSR Performance Level Prior to Succession Event*	Number of Successions	External Successor	Internal Successor
Strong	96	5.06%	43.07%
Mid	96	31.93%	29.38%
Low	97	51.89%	0.97%
Overall	289	16.47%	12.57%

*The performance level prior to the event is determined as the difference in one-year TSR for the organization and the one-year TSR for the S&P 500.

Source: Sibson Consulting

The following "litmus test" can help determine whether an organization is effectively managing succession as a critical business tool. An enthusiastic "yes" should follow each of these statements:

■ The board and CEO have clear and significant roles/responsibilities in actively managing succession as a critical business imperative.

■ Succession management is a significant accountability for the CEO in managing leadership development of the most critical talent in the organization and the CEO holds accountable those who manage critical talent.

■ The organization is truly committed to proactively addressing leadership needs and critical talent development, and deploys the needed resources to make leading-edge succession management a reality.

If an answer to any of the statements above is anything other than an unqualified "yes," it is highly likely the organization is at risk of losing any competition for critically needed leadership talent.

Strategic management and deployment of succession management practices is one of the most important responsibilities of the board and the CEO in ensuring both business continuity and stewardship of an organization for the future.

ROBERT CONLON *(rconlon@sibson.com) is a senior vice president in the Chicago office of Sibson Consulting.* RICK V. SMITH *(rsmith@sibson.com) is a senior vice president and Executive Compensation and Governance practice leader in Sibson's New York office.*

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