

Perspective

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Effective succession planning: The board's role

Succession planning is moving to the top of board agendas according to a recent study of CEO succession planning practices of Fortune 500 companies conducted by the National Association of Corporate Directors (NACD) and Mercer Delta.¹ The graying of executive ranks combined with high CEO turnover has intensified the importance of this issue.

It used to be that a board member might encounter a CEO succession about only once every 10 years. Today, a typical board may be charged with selecting a CEO's successor multiple times even within a single term. Directors now recognize the significant business risks they face if they fail to identify and develop appropriate leadership talent. The quality of a company's leadership is one of only a few sustainable competitive advantages; acquiring and retaining the right leaders has become as – if not more – important than having the right strategy.

In light of the current corporate governance environment, according to the NACD/Mercer Delta study, boards feel responsible for having a CEO successor candidate identified. This heightened awareness, in turn, has affected succession planning more broadly in organizations. This *Perspective* discusses the challenges and opportunities for leadership succession planning – for the CEO role as well as the top 10 to 20 percent of senior management who occupy critical strategic leadership roles in the company – and the key requirements boards need to keep in mind to ensure corporate success.

¹ The Role of the Board in CEO Succession, *National Association of Corporate Directors*, 2006.

Boards should keep the following hard questions in mind about future leadership talent:

- What are the capabilities and talents needed to lead our organization in the future? Given the dynamic nature of the market, technology and competition, will they be different than they are today?
- Should we buy or build the capabilities we need?
- Where is the next generation of leaders? What are we doing to prepare them?
- With a change in strategy, do we have the senior leadership in place to make us successful?

Succession planning and leadership development

Succession planning should not be confused with leadership development. The former focuses on the identification of appropriate candidates for key positions, determining the right mix of capabilities required for the target job within a specific time frame. The latter focuses on preparing individual leaders to handle more complex roles effectively – determining an individual’s potential to grow into certain roles given the right experiences to hone and maximize their talent. Identification of leadership talent without development does little to prepare the organization for dealing with its future challenges.

Combining succession planning with leadership development differs from traditional succession planning, which often “pegged” individuals, slotting them into jobs without active orchestration of their development. Too many organizations rely on a “survival of the fittest” philosophy that may put talented people into leadership positions without attention to coaching or the development of skills and characteristics important for higher-level roles.

Successful leadership development means creating a developmental culture. According to our research, the premier organizations have an environment that is continually nurturing and growing the next generation of leadership while still meeting day-to-day requirements. Too many of the organizations that we are asked to work with treat development as something they address only when they have to – because of anticipated turnover in a critical position – or as an optional activity when they have time.

In successful organizations, senior management is continually integrating the testing and stretching of the capabilities of high-potential performers while balancing the need for meeting short-term performance goals. In other companies, the immediate performance issues distract senior leadership and the board from addressing developmental needs and experiences.



The board owns executive succession planning; the CEO manages it

Traditionally, companies entrusted succession planning to the CEO, relegating the board to an oversight role. But several headline-grabbing succession failures in well-known, publicly traded companies have highlighted the importance of rational, logical and straightforward analyses in succession planning to aid decision making. Board independence and objectivity uniquely positions its members for this responsibility.

Like so many other arenas of corporate life, power, anxiety and control dictate what people do. CEOs (and their executive teams) are only human and frequently find themselves embedded in a web of interpersonal relationships, the past histories of which can cloud what's best for the organization.

In the absence of real succession planning, one or two outcomes can occur when a leadership position opens. Either a candidate emerges because of a *perception* that he/she is viewed as being “good” or “strong” without doing a disciplined analysis to determine if the candidate's strengths (and weaknesses) in fact line up with the new and different demands of the next higher-level role. In this case, the organization is taking a gamble. Alternatively, from the individual's perspective, the “fit” for a role may be so perfect that the job may not offer opportunities to add new skills, capabilities or experiences that will help round out or expand the person's skill set. In either case, there can be poor judgments about a candidate's appropriateness for a specific role, which dilutes the value to the organization of that person gaining and growing from the experience.

The board's knowledge of business strategy and planning optimally positions it to lead succession planning, driving the process through the organization and maintaining a longer-range view of the business's requirements. We encourage boards to work in partnership with the CEO to define straightforward relationships that avoid confusion. A board member reinforced this point: “There must be a clear understanding of the roles and responsibilities for the board, the CEO and the chairs of the various committees. In succession planning, any ambiguity creates problems. It is not a difficult discussion to have [with the CEO] if the board recognizes its responsibility. If the board avoids these discussions, shame on them.”

Some CEOs are concerned about mentoring talent and grooming future leaders. However, we urge a healthy system of checks and balances in this critical arena. Boards who cede their power and influence over succession planning to the CEO risk chronic talent gaps and leadership failures. The board's role is clear: provide oversight and render an independent, objective and emotionally unclouded decision on future leadership candidates.



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Succession is a process

Many of the directors we have spoken with who run a “tight ship” on executive succession emphasize that their commitment to leadership development stems from the realization that they are stewards for a unique culture, which is itself a **business asset and worth protecting**. These boards focus on what will be needed to drive the organization’s strategy and culture and guide the CEO in building a leadership pipeline to ensure a broad cadre of future leaders.

In too many organizations, succession planning is viewed not as a process but as a one-time event that might be better called *replacement planning*. Instead, we advocate a continual process of selecting, shaping and molding talent, rather than acting in response to an acute need. When asked why one large multinational company continually had a pool of ready executives, the lead director commented, “We start early and we start constantly.” This board was actively involved in senior-level development. It was also keenly aware of critical talent that was “poachable” by competitors, making sure to retain these individuals through a positive and promising professional experience.

The board compensation committee plays an important role in this particular matter. Executive pay packages should be designed to retain and motivate critical managers during periods of transition, which can extend over long time periods when the leadership “cupboard” is bare and no replacements are in sight. This places an even greater premium on the board’s tending to internal succession planning, as negotiating with outside senior executives becomes even more delicate and expensive. These candidates know they’re in the driver’s seat. In a way, the organization is held hostage since it lacks an internal contingency plan for replacing key executives.

A leadership development culture

Too many times, well-meaning HR executives and general managers devote time and energy to coaching, grooming and moving individuals around to ensure they gain critical experiences. And too many times senior management overrides these efforts by bringing in their own “choice” for a critical role, thereby undermining development efforts and creating cynicism about the development process. Many a manager who has been passed over has commented, “What’s the point? The CEO will make the decision anyway based on his/her preferences.”

Developing successful leaders is a mixture of art and science. First, it must be anchored in a rigorous, disciplined process of assessment, feedback and development. That is the science. Second, it must recognize talent early on and nurture it – the art – which is what boards find daunting. Have you known professionals who have been labeled “high potential” when in fact they are just forceful extroverts who come across well in meetings? In addition, individuals do not all mature according to a precise time line. The analogy of planting seeds in a fertile environment and allowing them time to sprout is more appropriate for leadership development than the mechanized view of preparing for future roles by bolting on additional features, competencies and attributes.

Successful companies have in place the sort of leadership development programs that churn out leaders year after year from their internal ranks to fill newly created positions, minting talent that competitors fight for. Their cultures, which actively ferment leaders by supporting and sustaining leadership development, have at least two critical elements:

1 They provide ample opportunities for promising managers to be continually tested (and retested) in jobs with clearly defined outcomes. The leadership development literature makes plain that genuine leadership skills are honed by on-the-job experience and polished by classroom training and development. These companies view each job or project as a new hurdle to be overcome or a developmental challenge to be mastered to indicate if the executive has what it takes to go to the next level. They do not treat high-potential lists as *fait accomplis*. Individuals and the organization continually sharpen their understanding of the person and how they can best contribute.

2 Equally important, most if not all of these companies have put a priority on developing internal leadership capability. They have taken the time, invested the money and scheduled the meetings to ensure that talent is continually being reviewed, job opportunities created, and *post mortems* conducted on both successes and failures. It is part of the air they breathe and is culturally bred into the manager’s DNA: “Your responsibility is to source, select, coach, mentor and develop future leaders. It is not *part of your job*. It is your job!”

The board needs to stay close enough to ongoing leadership development efforts so that directors have personal experience with high-potential candidates directly, rather than relying on the CEO for second-hand impressions or his hand-picked choice of successors. The board members need to get to know the individuals and become familiar with the developmental experiences so that they can offer valuable insights into the leadership development culture of the organization. The board also needs to find ways to provide oversight to be sure that management is priming the leadership pipeline.

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How can boards best accomplish these goals? The following table presents some suggestions:

| Board checklist: Oversight of successful leadership development and succession planning | |
|--|---|
| Do | Do not |
| <ul style="list-style-type: none"> ■ Show an interest in leadership capabilities at all levels ■ Periodically (annually/ bi-annually) attend a formal talent review as part of the board's ongoing business ■ Have an understanding of both the quality and quantity of talent available to replace individuals in critical jobs and monitor their individual developmental progress ■ Insist on meaningful business interactions over time to develop first-hand observations of key talent ■ Keep track of how placement decisions (both from the inside and the outside) have worked out ■ Provide oversight and a "real world" perspective on leadership capabilities and the competitive market | <ul style="list-style-type: none"> ■ Insist on meeting all high-potential candidates in person ■ Try to do human resources' or the CEO's jobs ■ Allow cursory reviews of capabilities to substitute for dynamic "give and take" discussions about the availability of talent for critical roles ■ Assume, all things being equal, that a senior-level outside candidate will "work just as well" as an insider in the existing culture ■ Ignore senior-level failures without conducting a post-mortem to understand what happened |

A vibrant leadership pipeline

Developing leadership talent is similar to research: the validity of the hypotheses about a person’s capabilities and attributes need to be continually tested and retested in a variety of roles and under varying circumstances. New roles become an opportunity for candidates to demonstrate “their stuff,” realizing that some of them may or may not have what it takes.

Boards need to recognize that managing individual performance to accomplish today’s work goals and, at the same time, to provide opportunities for developing talent is in the words of business writer Jim Collins, a “both-and” not an “either-or” issue. The management team is responsible for executing this development process, but the board needs to monitor it and to ensure it is being effectively executed. Boards should make this an active process to assess and test potential leaders’ capabilities over a long enough period to build a vibrant leadership pipeline.

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Additional resources

To order *The Role of the Board in CEO Succession*, a best practices study published by the NACD in collaboration with Mercer Delta, visit www.mercerdelta.com/organizational_consulting/ceo_succession.html.

For more information on managing executive talent, see *Perspective 51: Outlook for executive compensation governance 2006: Beyond due diligence* and *Perspective 43: CEO performance evaluation – Getting it right*, which may be found at www.mercerHR.com/perspective. You may also be interested in Mercer Delta's new book *Building Better Boards: A Blueprint for Effective Governance*. See http://www.mercerdelta.com/organizational_consulting/building_boards.html for details.