NYSE: Corporate Governance Guide

15 Succession planning: strategies for building the pipeline

Cathy Anterasian, North American Leader, CEO Succession Services, and Dayton Ogden, Global Leader, CEO Succession Services Spencer Stuart

At any company, one of the most important responsibilities of the board and of the CEO is ensuring an uninterrupted flow of capable management. Boards and CEOs that do not make succession planning a priority can put at risk their company's ability to carry out its strategy or to respond to new competitive threats, potentially shaking the confidence of both the organization itself and the financial markets. The risks of complacency or poor planning are steep when it comes to talent development and succession, especially as succession has become a growing concern for investors.

Successors and succession plans rarely just emerge. They are a product of the board's commitment to thoughtful, diligent planning and a willingness to hold the CEO accountable for the process. Boards that embrace this process work with the CEO to ensure that senior executives receive the appropriate developmental opportunities, including exposure to the board and potentially to outside board experiences, and push to meet a broad range of top executives.

A rigorous succession planning process

The NYSE Corporate Governance Guidelines state that listed companies must adopt and disclose corporate governance guidelines around management succession: "Succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO." In practice, boards must balance the need to provide appropriate information about the CEO succession process to fulfill their fiduciary and legal obligations with the need to protect sensitive internal information about potential candidates from being made public.

In our experience, a credible and sustainable CEO succession planning process involves the following:

- Preparing over time for an orderly, well-executed handover that proceeds from a robust management development process.

- Developing contingency plans to deal with other succession scenarios, for example, a death, health crisis, or other personal reason, that force a sudden CEO transition, or performance problems requiring an accelerated succession.
- Driving agreement about the long-term strategic direction of the company and developing CEO selection criteria based on the future needs of the business. A very precise and thoughtful profile should be the compass that guides the board in making tough decisions throughout the process.
- Defining the respective roles of the board, the committee, the CEO, and the management team in succession planning, and establishing the mechanisms to make succession planning an ongoing and real-time process.
- Assessing potential internal candidates based on the defined selection criteria, understanding their strengths and development needs, and then creating development plans to close any gaps. It is important that internal candidates feel good about this process.
- Gaining an understanding of the talent marketplace and how internal candidates compare to external talent benchmarks.
- Ensuring the CEO and chief human resources officer are overseeing an active and effective C-suite succession program so that all senior executives accumulate the experience and skill sets they need to be effective.
- Regularly reviewing the succession plan and adjusting when necessary.

The value of starting early

When should succession planning begin? While somewhat counterintuitive, ideally, the process should start early in a CEO's tenure. Starting early and creating a normal cadence around executive development and long-term C-suite succession planning increases the chances that strong internal candidates will be identified, assessed, and ready when a transition is near. Boards that wait too long to begin the succession planning process may find that there is not enough time to address the developmental needs of candidates with high potential. Starting early also allows directors to have more interactions with potential candidates over time, so they can observe patterns of performance and behavior and gain deeper insights into candidates' succession readiness. Finally, when C-suite succession is an established process—rather than a response to an imminent transition—it can minimize the emotion and drama from the process because it is business as usual.

Tie the profile of the future CEO to the strategic direction of the business

The foundation for CEO succession planning is the strategic direction of the business, from which the profile and selection criteria for the future CEO can be developed. Getting this right is critical because the CEO criteria provide a road map for internal candidate development plans and a framework for selecting from among finalist candidates.

A potential pitfall for the succession planning process is basing criteria for the next CEO on a strategy that is too rooted in the present or relies on status quo assumptions, rather than a view of where the company needs to be in five to 10 years. When this happens, the criteria for the next CEO may not be tied to the specific strategic, organizational, and operational levers that the next CEO will need to employ, potentially impeding the development of internal candidates with these capabilities. Very simply, if you don't know where you want to take the company, it's hard to evaluate who is the right person for the company's next phase—some executives are skilled at growing a company; some are experienced in turnarounds; some are perfect for maintaining the company's current course.

Wise boards agree on strategic issues up front, since these decisions will influence the kind of future leader or leaders the company will need, and push themselves to go beyond generalities. They identify the very specific effect the next CEO needs to have on the business and define the skills that it will take to accomplish that. These could include invigorating the innovation pipeline, applying disciplined cost management, pursuing specific growth targets in emerging markets, or building new organizational capabilities to drive organic growth.

In addition, boards should consider the question of cultural fit. If the organization's culture is viewed as a valuable asset, then—all things being equal—the board should favor a profile that fits into the culture. In other cases, the culture of the company can be an impediment to its success. A culture that is too invested in its own ways of doing business and not learning and changing in a dynamic market may require transformational change. In these cases, the board will give more weight to the capabilities needed to transform the culture.

Agreeing on a future-looking strategy that informs the criteria for the next CEO is a critical step that helps make the process go smoothly. It also helps boards avoid the trap of choosing an executive who mimics the incumbent's strengths.

Adopt best-in-class assessment approaches

By definition, potential internal candidates for the CEO role are not proven CEOs, so how can boards gain better insights into their ability to succeed in a role that is dramatically different in scope and complexity? Unless boards are diligent, evaluations of succession candidates tend to be relative to the roles executives are in today rather than mapped to the future. To gain the insights they need to understand the capabilities of their company's executives and make the discerning judgments about their readiness for the top role, boards need to embrace an assessment process that is fact-based, rigorous, and forward-looking.

A board's ability to choose a CEO successor requires a frank view of executives' readiness, including an understanding of their development needs based on the future direction of the company and the likelihood of their being able to close any gaps in a reasonable amount of time. Boards should understand candidates' track records delivering against the same strategic and operational levers that the next CEO will be required to pull, drilling down into the specific contributions individuals have made in the businesses they have run. In addition, boards should strive to gain an understanding of an executive's potential to stretch into the CEO role.

Executives' analytical capabilities, social intelligence, and self-awareness are all skills that speak to their ability to succeed in more complex and demanding contexts. CEOs must operate amid greater ambiguity and complexity than in their previous roles, so understanding whether executives have the skills to navigate these challenges is critical. Assessing candidates' business judgment and self-awareness also can shed light on which executives will be best able to learn, develop, and adapt as CEO. This is no small consideration in an environment in which the one thing boards can be sure of is that the collection of issues and challenges facing the business when the new CEO is named will be different six months later.

A careful review of individuals' competencies, including the observations of others who can validate their performance in current and past roles, can reveal whether candidates have the relevant experience and identify potential gaps. Gaps may include a lack of specific knowledge or experience, traditional "hard skills," such as experience with regulators or financiers, or a deficiency in certain "soft skills"—behavioral skills such as the ability to navigate complex interactions or to influence, motivate, and create followers, among others. Boards also will want to consider whether the culture of the company needs to evolve, and how aligned individual candidate profiles are with the desired company culture.

An additional component of candidate assessment is benchmarking internal executives against executives outside the organization. Companies that are strong producers of executive talent sometimes lose a sense of how their leaders compare to the best-in-class talent externally or overlook how the world has shifted around them. Taking a look at external talent—through research, informal or formal introductions or an executive search—can provide additional insight when assessing the readiness of potential successors. Ideally, benchmarking should happen in tandem with internal assessment, so that the results of the internal assessments and external benchmarking can be compared simultaneously. This process is critical to giving the board a good sense of the relative strength of the internal candidates, as measured against outside talent who have proven themselves as skilled in the operational areas that will be critical for the company's future success and have demonstrated the values and behaviors that align with the ideal company culture.

Planning for other succession scenarios

History has proven that unplanned leadership vacancies occur, so preparing for the succession of the CEO over the long term is not sufficient. The unexpected can happen: Illness, death, unanticipated family demands, or poor performance can end a CEO's tenure. A CEO may decide, due to illness or for other personal reasons, to leave earlier than planned, or be recruited away for a new career opportunity. It's critical, then, that boards stay vigilant in reviewing the company's succession readiness.

As part of ongoing succession planning, boards should plan for an emergency situation requiring a sudden change in leadership. This plan could involve internal executives who are far enough along in their CEO readiness, a current board director, or a retired CEO as potential candidates to immediately step in as acting CEO on an interim basis. Boards also should discuss accelerated succession scenarios, which can be implemented if the board begins to have concerns about the performance of the CEO or its own relationship with the CEO.

The board and the CEO should establish together a strategy in advance and define the procedures that will take effect if an emergency occurs. The chairman of the board or of the committee responsible should know the potential candidates who are willing to take on management responsibility in an emergency or which board member may be able to step in.

Creating a succession committee

Succession planning is arguably one of the more interesting responsibilities of the board—and a task that many board members are eager to be a part of. It also can be one of the most intensive board responsibilities, depending on where the board is in the process, requiring significant work between meetings. While the entire board should be involved at critical touch points throughout the succession planning process, a smaller succession planning, nominating, or personnel committee—that includes only directors who are the most qualified and who have the necessary time—can steer the process for the board and handle the granular work associated with assessment and benchmarking.

In our experience, the ideal size of this group is three or four directors. The lead director or non-executive chair is often included in this group, and it can be helpful to include two board members who have the expertise of being former CEOs, but who are not active CEOs, given the time commitment. It is even better when at least one of these former CEOs also chairs another committee such as the nominating, governance, or compensation committee. However, boards may want to avoid assigning the audit committee chair to this task because of the time commitment for that role. The succession planning group often may include the company's current CEO acting in an "of counsel" capacity.

As this committee takes ownership of many of the details of succession planning, it should keep the rest of the board up to date and ensure its continued buy-in throughout the process. This should happen at the beginning to ensure that the board understands the process; upon the development of the key selection criteria for the position; at the review of the assessment summary of internal candidates; and upon the review of the benchmarking information on external executives.

The CEO's role in succession planning

At the most basic level, the CEO's role is straightforward: driving management succession at senior levels, including the early identification of any inside CEO contenders, ensuring that the organization is developing succession-ready executives, and serving in an of counsel role to the board. The CEO is in the best position to make sure directors have the insight they need by working closely with the chief human resources officer (CHRO) to ensure the company has a robust, forward-looking approach to executive talent development.

The CEO should make sure that the CHRO is thinking about development plans for potential internal candidates with a forward-looking lens, assessing individuals based on the future requirements of the business, and translating those requirements into specific developmental opportunities. The CEO and board can benefit from bringing in outside assessment expertise when evaluating how the internal team stacks up against the requirements and external benchmarks, particularly when the business may require a change in strategic direction.

As the time for a transition nears and the process turns toward the board's selection of finalist candidates and potentially a search, the CEO's participation diminishes.

Developing a robust pipeline: the board's role in broader C-suite succession

While the board should be deeply involved in succession planning for the CEO role, less agreement exists among experienced directors about how involved the board should be in influencing talent decisions further down in the executive team. At a minimum, the board should be confident that the CEO has a strong team and that the organization has an effective succession planning process in place for other key executive roles.

Many boards monitor the succession planning for the top 10 or 12 positions in the company, making sure development plans are in place for these executives, that they are given challenging assignments or new roles, and that they gain exposure to the non-executive directors, for example, by presenting during strategy meetings.

At a broader level, boards want to be confident in the succession pipeline, ensuring that the CEO is focused on developing a succession-ready team and that directors have the insights about potential CEO contenders they will need to provide the necessary developmental assignments and, ultimately, to choose a successor. This ideally is a broad-based effort that incorporates up-to-date profiles for all the senior team positions, regular assessments and benchmarking, and thoughtful developmental assignments.

This does not mean that directors must become talent managers. It does require boards to take responsibility for ensuring that the right processes for talent management are in place and that they have the appropriate knowledge of potential leadership. Directors should get to know the senior leadership through presentations in the boardroom and regular meetings outside of it. Boards should plan on a deep-dive talent review at least once annually, which includes having the CEO and top HR executive lead a discussion about forward-looking leadership requirements against which talent can be evaluated. By being involved on an ongoing basis, the board can observe patterns of performance and develop a more nuanced point of view on executives' strengths and weaknesses.

Conclusion

Succession planning works best when it is viewed as a critical, ongoing board responsibility closely tied to management development. Among companies that do it best, succession planning is not focused solely on selecting the next CEO but instead involves a top-down and bottom-up approach to developing management talent for all key positions. These companies tend to share several common characteristics:

- They have strong boards that stay deeply involved in the succession planning process with the CEO on a continual basis.
- They continually expose their top management team to the board.
- They encourage "next-generation" CEOs to gain exposure to the media, the investment community, and, sometimes, outside board service opportunities.
- They view succession planning as an ongoing process that is linked to the strategic planning process to ensure a fit between where the business is going and the skills of likely successors.
- They minimize the human drama in the succession process by creating conditions for a predictable outcome.
- They periodically calibrate likely internal candidates for CEO against comparable outside leaders.
- They develop a "succession culture" in which all levels of the organization plan for the inevitability of change by ensuring that top executives and high-potential leaders throughout the organization are given the proper tools, exposure, and training to develop into contenders for advancement.

Spencer Stuart
353 N Clark, Suite 2500
Chicago, Illinois 60654
Tel +1 312 822 0088
Web www.spencerstuart.com

Cathy Anterasian
North American Leader, CEO Succession Services
Email canterasian@spencerstuart.com

Ms. Anterasian leads CEO Succession Services for Spencer Stuart in North America. She is an active member of the North American Board, CEO, Technology, Media & Telecommunications, and Consumer practices. Previously she launched and co-led Spencer Stuart's global Executive Assessment Services practice. Ms. Anterasian has more than 25 years of experience in succession planning, assessment, executive search, and strategy consulting. She advises boards and chief executive officers on the capabilities and potential of their teams, as well as on the development of strategies and plans to prepare executives for CEO succession and other C-suite roles. Ms. Anterasian has partnered with numerous boards and CEOs of Fortune 500, mid-cap, and privately held companies to ensure that successful leadership development, selection, and transition occur. She has engaged with clients globally across financial services, life sciences, industrial, technology, retail, and consumer sectors.

Julie Hembrock Daum
North American Leader, Board Practice
Email jdaum@spencerstuart.com

Ms. Daum leads the North American Board Practice and serves on the board of directors of Spencer Stuart. She consults with corporate boards, working with companies of all sizes from the Fortune 10 to pre-IPO companies, and has conducted more than 1,000 board director assignments. A recognized expert on governance topics, Ms. Daum helped found and develop the Wharton School's Corporate Governance: Fresh Insights and Best Practices for Directors program and is regularly quoted in The New York Times, Financial Times, Businessweek, Time magazine, and The Wall Street Journal. She is also the coauthor of the recent business book You Need a Leader—Now What? How to Choose the Best Person for Your Organization.

Dayton Ogden
Global Leader, CEO Succession Services
Email dogden@spencerstuart.com

Mr. Ogden is the global leader of Spencer Stuart's CEO Succession advisory services and a member of the Board and Industrial practices. His search-consulting work focuses on senior executive and board recruiting for international clients. He is commentator on key trends and issues affecting CEOs and boards, both in the US and internationally. In 2000, Oxford University Press published CEO Succession, which he coauthored. Mr. Ogden draws from direct board experience for client work, currently serving on the board of the American Business Conference, an organization that includes the CEOs of emerging growth companies. He is also secretary and a director of Project HOPE, a leading health-care foundation based in Washington, D.C. Mr. Ogden was elected chief executive of the firm in 1987 and in 1993 became the first CEO in the firm's history to be re-elected to a third term. He served as chairman from 1999 through 2006.

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- Overseeing a succession plan for senior management
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