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LESSONS FROM THE BOARDROOM

SEVEN SUCCESSION PLANNING MISSTEPS BOARDS SHOULD AVOID

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Succession planning for the CEO role is a key responsibility of single-tier boards, just as responsibility for the succession of the entire executive committee is the supervisory board's obligation in a two-tier system. The days of boards waiting until several months before a transition and then accepting or rejecting the recommendation of the outgoing executive regarding internal candidates are largely gone. In well-governed companies today, boards fully understand that effective succession planning is an ongoing process that requires consistent, dedicated work on their part.

As they approach this complex and highly political task of succession more seriously, however, even the most well-intentioned boards can encounter pitfalls that can derail the process, offend internal candidates or negatively affect employee morale or the company's reputation.

This article highlights the missteps boards make most often in succession planning. By avoiding these mistakes, boards can handle succession planning more sensitively and sure-handedly to create a process that allows all parties involved — from the board directors to the incumbent executive, internal candidates and the company as a whole — to benefit from the experience.

Failing to align on strategy

Before deciding on a future leader, board members need to agree on the strategic direction of the company. Most board members assume their company has a fairly well-articulated strategy, but we have witnessed situations in which there was, in reality, fundamental disagreement between individual board members as to where the company should go. For example, one director may favor emphasizing the high-volume part of the business that earns the lowest multiple, while another sees more potential in focusing on the riskiest part of the business that earns the highest multiple but could sink the ship.

Wise boards reach universal agreement on these strategic issues up front, since these decisions will influence the kind of future leader or leaders the company will need. This is a critical step that helps make the process go smoothly, and helps boards avoid the common trap of choosing an executive who mimics the incumbent's strengths, instead of selecting the candidate with the qualifications best suited to the company's strategy for the future.

Over-involving the entire board

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 is also one of the most time-consuming board responsibilities, 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 for a single-tier board. The lead director or nonexecutive 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. In some governance models and markets, the succession planning group may also 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.

Conducting internal assessments too late

Once the list of key qualifications for the role has been approved by the board, it is generally best if the assessment of internal candidates takes place as quickly as possible. The more time internal candidates have to focus on their developmental areas, the better the chance that one or two of them can become a serious candidate. If an executive is told three months before the transition that he or she really needs an international assignment to get ready for the role, obtaining that experience is not a realistic option. But if that information is shared a few years in advance, the executive can gain the experience needed to contend for the role.

By conducting internal assessments early, boards also have a chance to create the proper developmental plans for those internal candidates who, upon assessment, are clearly not ready to assume the role during the next transition. Medium- and long-term planning keeps executives engaged and builds the company's bench strength for future succession opportunities.

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Creating a "horse race" too early

Whenever possible, companies should conduct a formal assessment of internal candidates two or three years in advance of an expected transition. However, avoid organizing a process that fosters excessive early competition between candidates or that intimates in any way that the process is an interview for the job.

Instead, it is usually more helpful to position the assessment exercise as principally supporting the career development of the people involved. The executives assessed will no doubt realize that the process could have bearing on succession. Because of this, we recommend clearly communicating that the company has decided to make a significant investment in their career by putting them through a rigorous process and giving them feedback. Internal candidates should be aware that the board will monitor their progress against their development objectives periodically over the next two or three years as it goes about its fiduciary responsibility of planning for long-term succession.

This approach can make the process a valuable — and valued — developmental exercise for each of the executives involved, rather than spurring a horse race between candidates that creates winners and losers and can negatively affect the company's retention of top executives who are important to the organization.

Another consideration in handling this politically sensitive process is to carefully choose the group that will undergo assessment — whether it is the executive committee, the operating group or the CFO plus any business heads. If this process is done properly and started early enough, there is no reason it cannot be a very constructive process for all concerned, including the people who do not get the job.

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Neglecting external benchmarking

The benchmarking of internal candidates versus external ones is a sensitive issue, but it is also an important component of effective succession planning. Just as companies benchmark their products, manufacturing operations and financial management processes against the best in class, they can also benefit from seeing how their executive leadership stacks up against that of other companies in their industry.

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 the outside talent pool that would likely be considered for the role, based on the priorities for the position.

It is generally best to be transparent with internal candidates about the purpose of and approach to the benchmarking process. In our work with clients, we benchmark internal candidates in two ways. The first is through an assessment instrument that will compare them against the thousands of other executives who have gone through this process, and the second is through a less scientific comparison of their strengths and weaknesses to those of select executives outside the company. Communication with internal candidates should stress that both steps are being taken to assist the development of the internal executives and help them become best-in-class leaders. It should also be reinforced that external benchmarking is not a search, but merely a confidential desk-based research exercise that evaluates the strength of potentially ready candidates on the outside.

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Overvaluing external candidates

When boards look at internal candidates, particularly those who have undergone rigorous assessment, they understand the strengths they could bring to the role — and are just as aware of their weaknesses. But because outsiders do not typically undergo the deep assessment that internals do, it can be easy to forget that they have downsides and development needs too.

For this reason, when there is genuine uncertainty about whether one of the internal candidates can be a favorite for the position, we often recommend that a gap analysis be performed. In this exercise, we take the best internal candidate or two and stack them up against the best external benchmarks using the selection criteria.

If the analysis results indicate that the external benchmark is at least 25 to 30 percent better than the internal candidate, we encourage the board to have a conversation with that person. If the gap is smaller, the risks of reaching outside the company may outweigh the benefits, especially for a healthy, well-run company. Every company has a unique strategy, history and culture. Even a highly skilled outsider might not turn out to be the best fit for the organization's values, way of operating or position in the market — and this is not always obvious in advance.

As a result, we always encourage boards to give their internal candidates every chance to get the appointment unless an outside candidate brings considerably more to the table. If the outsider does, the board must make the important decision of whether to conduct discreet conversations with select externals or whether the internal options are so weak that they want to conduct a broad, engaged search, a process that ideally should begin nine months to a year before the transition.

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Failing to update the plan

While many of the points in this article discuss suggested steps leading up to a planned transition, succession planning is an equally important fiduciary responsibility of board members when no obvious transition is on the horizon. Moreover, being prepared for unexpected transitions is a major factor separating well-governed companies from poorly governed ones.

Now more than ever, companies and the markets they serve are dynamic. Succession plans and the key specifications for the role that underpin them should be adapted regularly to reflect these changing realities. At a minimum of once a year, and preferably more often, the succession planning committee should evaluate and, if necessary, revise the specifications for the role (or roles for a two-tier board) to ensure they are current. They should also review the progress of internal candidates against their development objectives and revise the objectives, if needed, to reflect the changing qualifications that will be needed for the evolving role.

Well-governed companies also take a longer-term view toward succession. The board's responsibility may not extend to a granular role in the identification and development of roles beyond the CEO role for a single-tier board and beyond the executive committee for a two-tier board. But it should make sure that there is a process in place to develop talent for all the top positions in the company, and that the pay of the CEO and other top executives is linked to their success in developing and retaining talent.

By taking these actions — while avoiding the pitfalls we have described — boards can more effectively prepare their companies for succession over the short term, and help build the bench strength that the company needs for stability and success well into the future.

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