An Ounce of Development Is Worth A Pound of Headhunting: The Role of The Board in Effective Succession Planning

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> *"Choosing the CEO is the single most important role of the board."*
> **David Yoffie, Director, Intel Corporation**

One of the most vital roles a board of directors plays is selecting a new CEO. Central to that selection is choosing a CEO best suited to lead the company to future growth. Where do boards find this CEO extraordinaire? Too often, the board is unfamiliar with high-potential internal candidates. Instead, it turns to headhunters who do what they do best – present external candidates. However, an external candidate may not be the best choice for the organization.

An effective executive succession plan driven by the board of directors can dramatically improve the selection and performance of future CEOs and those promoted under them. That is why the board must ensure that a well-designed succession process is in place. Here is a mythical, but entirely believable story:

During its forty-year history, the NE Corporation demonstrated all the signs of an organization with superb management depth. Its shareholders were rewarded with steady earnings growth and frequent analysts' upgrades. So when President Roland Paul announced his retirement, the board rubber stamped Paul's recommendation that his second-in-command, Ralph Richardson, take the reins. Richardson responded with, "No thanks. I don't want the pressure." Paul belatedly recognized that he had no other suitable internal candidates and that his own retirement was now in jeopardy.

Even under such "natural" conditions – the planned and voluntary retirement of the CEO – the board's responsibility is to ensure the selection process turns up the CEO-to-be with the most potential. The process needs to be just that – a process that incorporates objectivity, measurability and fairness. It also needs to be comprehensive, reaching down to first line managers, as the promotion of an internal candidate creates a domino effect of additional internal openings.

Organizations do not experience the future as a repetition of the past. While companies use historical data to forecast financial trends, planning the organization's leadership needs is quite a different matter. A board that visualizes future challenges will do a better job of selecting the critical competencies and skills that the new CEO will require.

Some of Canada's largest public companies do devote time and energy to succession planning. A review of annual filings from the *Globe and Mail*'s Report on Business 2006 Top 1000 list reveals that nine of the ten largest companies by assets have formed a board sub-committee to deal specifically with succession and developmental issues.

Can we generalize from this limited finding that most boards are truly engaged in an effective and meaningful succession planning process? Based on a U.S. study, the answer is no. In 2004, Mercer Delta Consulting and the University of Southern California surveyed 221 directors serving on the boards of 200 of the top 1,000 U.S. public companies. They found that only 26 per cent of corporate directors felt their board participated "to a great extent" in the development of internal candidates for future positions.

Inside or outside?

Faced with an imminent CEO departure or wanting to trigger one, most board members turn to a headhunter to provide "independent advice." Like a carpenter who solves every problem with a hammer, headhunters are motivated to address succession problems by parading a stream of external *wunderkinds*. After all, what search firm wants to be in the position of charging a fee for you to hire your own employee?

Of course, whether to promote from within or look outside has implications beyond the boardroom. The board needs to come to grips with a critical question: Is the organization best served by a continuation of the way things have been or by the possibility of disruptive change?

Internal candidates supply the comfort of "the devil you know." When one ascends to the CEO throne, it sends a strong message to the rest of the organization. Ideally that message is "we value loyalty and hard work" and not "seniority determines outcomes." Internal candidates also bring the promise that change will be evolutionary, not revolutionary. The core of the organization's culture is likely to survive intact.

On the other hand, external candidates often arrive without any negative baggage. If a major change is truly required, going outside for the right skill set is highly appropriate. However, boards should not mistake a "clean up" manager, like former Sunbeam CEO "Chainsaw" Al Dunlop, with someone who is capable of building a sustainable business.

The outsider has a rare opportunity to transform an organization, its values and culture, and to take it in a new direction. The risk is that the outsider may throw out "the baby with the bath water." Through ignorance, rather than design, newcomers may eradicate elements of the culture that made the organization great. Of course, not all external fills are toxic. Lou Gerstner, CEO of IBM from 1993 to 2002, felt that it was his position as the "unaffected outsider" that enabled him to turn around the troubled company.

A study by the Center for Creative Leadership reported that a whopping two-thirds of senior managers hired from outside usually fail within the first 18 months. By comparison, 65 per cent of leaders selected internally are successful in their position. The contrasting results are even more disappointing when factoring in the premium compensation packages used to attract outsiders and the accompanying fees paid to executive search firms.

The high failure rate of outsiders begs for an examination of flaws in the process. Headhunters can be very persuasive in backing their preferred candidate. By comparison, boards may not know the internal candidates well enough to form an educated opinion. Given the choice between an understated internal candidate and a well-marketed external candidate, it is no wonder outsiders often get the nod.

Only long range succession planning, supported by effective training and development, ensures that there is even a choice to be made.

Developing a better way

Developing and grooming one or more successors to the CEO is a long process … usually longer than the notice period given by the retiring CEO.

At Intel, according to Board member David Yoffie, planning starts ten years out. Further, the Intel Board goes to extraordinary lengths to keep its CEO successors incubating successfully. A significant part of this planning process, as explained by K. Girard in *Succession in the Valley* (The Chief Executive, June 2005), is a pairing of top executives to overlap each other's job duties. Top executives get to hone their skills in new, unknown areas. The result is that every CEO in Intel's 40-year history has been "homegrown".

A manager who steps up to head a single business unit is required to make major shifts in thinking, but that pales when compared to the shift required to fulfill the CEO role, including:

- Going from managing a narrower function, like sales and marketing, to integrating all of the functional areas of the business;
- Moving from delivering results that meet team commitments to thinking about overall financial impacts (for example: If I increase sales, do I force more overtime in the plant?); and
- Learning to utilize staff departments such as finance, human resources, and market research to provide analytical support for decision-making.

CEO successors do not learn how to make these shifts on their own. They learn by being exposed to situations that require an adjustment to how they think and how they manage.

Out of the classroom and into experiential learning

Cross-functional exposure on ad hoc work teams can provide valuable experience when individuals are assigned to solve problems greater in scope than those faced day-to-day. The board's role is to ensure that the CEO organizes teams to solve a real strategic problem, rather than a make-work one. Board members should interact with executive team members so they can obtain first-hand knowledge and assessment of skills and competencies. Directors also need to ensure that the team's recommendations are given an honest hearing with useful feedback. Ideally, one or more team members should be given the opportunity to implement the recommendations, thereby allowing the board to evaluate the outcomes.

Another approach is for the CEO to assign candidates to work on due diligence or the building of partnerships, alliances or joint ventures, with board oversight. The benefit of these approaches is that they facilitate exposure without removing someone from a critical role. The risk is that the added workload results in burn-out.

An interim secondment allows the board to observe candidates as they step into a completely different position for a defined period of time. These secondments must be long enough for the executive to learn about a different area of the organization and be measured fairly on results. When done, the individual may step back into the previous role or be ready for promotion.

The hallmark of all of these opportunities is the development of integrative thinking. Not only do candidates step outside their comfort zones, but they may have to assume a new perspective.

The highest quality of developmental exposure takes place when an incumbent can be moved (or promoted) into a much larger role such as working in another country, managing a major customer relationship or overseeing unfamiliar technology. One Caliper client assigns top project managers to open and operate a new business unit out of province. The challenge is to simultaneously learn people processes as they staff up, while developing new customers to meet the office's financial objectives.

Putting the success in succession

While there may be valid reasons for looking for the next CEO outside the company, the absence of a process that identifies and develops existing talent should not be one of them. Boards must be proactive, forward-thinking, resourceful and involved to sustain organizational effectiveness. Development of future talent is too important to be left to executives consumed with the struggles of day-to-day operations.

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