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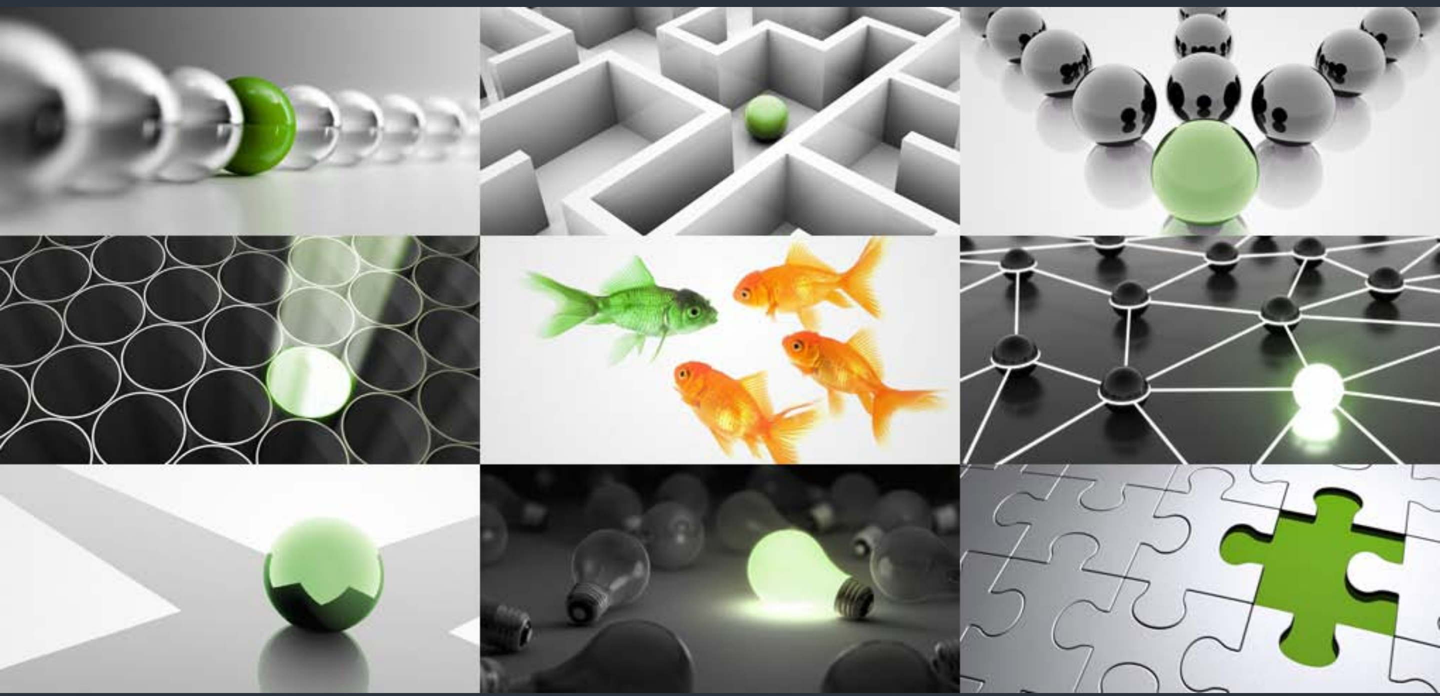

Rialto White Paper:
Succession Planning

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1. Introduction

The majority of boards consider leadership succession planning as a crucial strategy for implementing and sustaining shareholder value whilst at the same time reducing risk. However, recent studies conducted with investors have shown that many organisations are lacking innovation and clear strategies when it comes to successful succession planning.

Investors now view succession planning as a corporate necessity which is a deliberative and systematic effort by an organisation to ensure leadership continuity in key positions, retain and develop intellectual and knowledge capital for the future, and encourage individual advancement.

As economic conditions continue to progress through unprecedented change, investors are demanding a wake up a call to boards by insisting that the succession planning process moves forward from being purely a name in the box exercise.

Ensuring that the right executives are in the right place at the right time doesn't just happen, it is an in-depth process of selection, identification, development and evaluation and conversational techniques which all form part of the planning agenda.

A recent study conducted by Integral Advisors, LLC and Board Advisor indicates that too many organisations fail to give succession planning their full attention at both management and board level. Key investment analysts, pension advisors, investment banks, private equity investors and ratings agencies were asked what they considered to be the main board responsibilities, interviewees ranked succession planning among their top three current concerns.

Furthermore, a study by PWC found that **65% of CEOs** surveyed planned to leave their organisation in less than a decade, **42%** within 5 years. Nearly half of these CEOs, however, had not done any real succession planning, while **61%** did not even have a likely successor in mind. While Board members are clearly aware of the importance of succession planning, a survey by Mercer found that **30% of corporate directors said their planning for succession was less than effective**.

A recent survey by Heidrick & Struggles of private and public companies found that:

- **50%** could not name a successor for their CEO.
- **39%** cited that they have "zero" viable internal candidates.
- On average, boards spend only 2 hours a year on succession planning.
- Only **50%** have a written document detailing the skills required for the next CEO.
- The majority of organisations ,**65%** , have not asked internal candidates whether they want the CEO job, or, if offered, whether they would accept.
- While **48%** of respondents think they have an extremely strong or very strong understanding of the capabilities of internal candidates, only 19% have extremely or very well established external benchmarks to measure their skills against.
- Only **50%** of companies provide on-board assimilation or transition support for new CEOs.

More disturbingly, The National Association of Corporate Directors (NACD) and Chief Executive magazine studies report that 40% of externally recruited CEO's last two years or less, while 64% percent have departed before their forth anniversary.

2. Succession Planning Risks

The Integral Advisors Study found the following risks were identified as critical and lead to negatively impacting an organisation's probability of succession planning success:

Succession planning process.

Does there appear to be a comprehensive succession planning process in place? Has the board developed criteria for the next CEO that reflects the company's business model and long -term strategy? Have high potential internal candidates been assessed against these criteria using credible and objective evaluation methodologies? How are those with greatest potential being developed? Is there an emergency succession plan – and who does it cover?

Senior team tenure.

Does the company have a long-tenured team or is there a mix of seasoned and more recently promoted executives? Is it likely that a critical mass of the senior team will retire at the same time as the CEO? Or has the senior team been turning over faster than a revolving door in their office building?

Key executive exposure.

Succession planning for a "founder" or other "iconic leader" is the most difficult. As such, where these elements are present, a heightened level of diligence on the issue of succession planning is required.

Bench depth.

Are there top positions without successors in the first and second levels of the organisation? Is there low or high executive turnover – and what are the ramifications of this for the company's talent pipeline? Does the company provide the board with a bench strength report that gauges readiness of succession candidates against job requirements? Or do they just receive a binder of photos and CVs?

Board engagement in succession planning.

Is succession planning a regular item on the board's agenda and that of the board committee overseeing succession? How has the board become involved in succession planning efforts to date, such as the development of future CEO criteria, the review of development plans for top candidates, the creation of an emergency CEO succession plan? Does the board get meaningful exposure to internal candidates for the CEO and other key executive roles?

Management development.

Are there well-defined career development strategies? Are high potentials being given new job assignments designed to facilitate their development or is movement relatively low or alternatively, characterised by far too much turnover? Are management development and/or succession planning goals reflected in CEO evaluation and/or evaluations of other executives?

Cultural factors.

Is the culture of the organisation likely to facilitate or inhibit succession planning?

Succession Risk Index*

	Low Risk	High Risk
Succession Planning Process	Clearly defined criteria. Valid executive assessments. Regular board updates.	Weak/no succession plan. Poorly communicated
Senior Team Tenure	Mix of seasoned and recently appointed executives	Long term nearing retirement.
Key Executive Exposures	Multi-generational diverse knowledge/skills. Introduce possible successors early on.	Iconic leader domination by one executive. Single generation of executives.
Board Engagement in Succession	Regular agenda item. Full board is well versed.	Limited board involvement. Infrequent board discussion of succession issues.
Bench Depth	Top five positions ready successors/ Low turnover in key positions.	Top five position with no successor. High turnover of second-level executives.
Management Development	Defined career strategies. Incentives to retain key leaders.	Inconsistent development. Unable to compete for talent.
Cultural Factors	Collaborative style encourages risk taking and innovation.	Command and control. Silos/turf wars.

*Source: Integral Advisors LLC.

3. External Vs Home Grown

Study exposes myths.

A recent study by two graduate-school professors confirms a trend in CEO successions, which have favoured outside hires for the past two decades. In their study, Professors Yan Zhang, of Rice University's Graduate School of Business, and Nandini Rajagopalan, of the University of Southern California's Marshall School of Business, expose myths about externally recruited CEO, that they make bolder short-term changes than internally hired CEOs because they are not bound by "social contracts" with employees and other constituents; that they seldom hesitate to cut costs or lay off workers; that outside succession equals change which equals better performance.

In reality, say the professors, bold changes can be detrimental to an organisation’s performance if they deviate from the firm's core competence or if the company does not have the capacity to execute the changes. Professors Zhang and Rajagopalan found that planned, inside CEO successors, on average, outperform outside CEO successors. This effect was especially noticeable under more challenging contexts, such as low pre-succession firm performance; high post-succession strategic instability; and high post-succession industry instability.

The professors say that new external CEOs often feel they have a mandate for change and the freedom to assert their will on the company. This is at the risk of not fully understanding the company, its culture and its key people. In fact, new outside CEOs often think that getting rid of key people is the best way to rid the company of past failings.

Not so, say the professors. "Our research shows that strategic changes under the leadership of an inside CEO fare much better than under the leadership of an outside CEO," they conclude. "Outsiders are typically good at rapid cost-cutting and divestment, but over time, those opportunities tend to dry up."

Professors Zhang and Rajagopalan also conclude that "the disadvantage of outside CEOs, relative to inside CEOs, is not temporary and persists over time." Their conclusion is corroborated by Kevin and Edward Coyne's study in the Harvard Business Review on how outside CEO succession is a disruption to the organisation, as it is usually followed by turnover of other management/team members. The departure of experienced top management can deprive the outside CEO and the organisation of valuable management talent.

In the Coynes' study of the top 1,000 U.S. companies, when a new CEO from outside the company was brought in, the involuntary turnover of senior management listed in the proxy statement averaged 26 percent, nearly four times the rate when the CEO did not change. The introduction of an external CEO often causes key internal leaders to depart and their positions get filled by more outsiders.

Aside from the myths uncovered by the studies, what causes directors to hire CEO talent from outside the company? The answer is seen in the growing view that the succession process is driven by the board's desire to quickly restore investor confidence rather than a careful consideration of the CEO competence and fit the organisation really needs.

In addition, the pressure to outperform competitors over the past decade has resulted in adulterating sound decision-making, effective risk-management and ethical behaviour in business leadership, all of which contribute to higher levels of CEO turnover and a desire to restore perceived confidence.

Case Study – Litany of Sins

The consequences of seeking outside CEO talent are reflected in the litany of sins committed by organisations that fail in financial crisis. The list includes striving to achieve unrealistic goals; taking excessive risks; making decisions based on numbers flawed by assumptions, poor estimates and an excessive focus on short-term performance.

There's also the problem of placing too much emphasis on improving share price as opposed to improving a company's quality, productivity and business performance, or excessively compensating executives for poor performance due to the "Lake Wobegon effect", the belief that a firm has top quartile leaders who will automatically deliver top quartile performance. A more subtle, but nonetheless critical problem is the loss of institutional culture and values due to short leadership tenure and high leadership turnover during a period of great change.

Prime Example

Look at the stunning resignation of Mark Hurd as Hewlett Packard's CEO, which not only resulted in an 8 percent drop in the company's stock price but focused attention on the HP board's failure to deal with leadership development and CEO succession planning a failure that first became evident with the recruitment of outside CEO Carly Fiorina, who walked away with a $42 million severance package when she was ousted in 2005. Hurd had been recruited from NCR, he, too, departed HP with a $42 million package.

HP's recruitment of a third new outside CEO within 11 years became a public spectacle, which ended in September 2010 when Leo Apotheker was named to the post. The drama continues as just recently it has been announced that Meg Whitman is replacing the harshly criticized Leo Apotheker in a bid to restore investor confidence – he has only been in the role for 11 months. The latest appointment was made without a formal CEO search and prompted renewed criticism on the board.

4. Effective Succession Planning

Succession planning is synonymous with top management, regularly citing CEO succession as a critical issue.

However, if companies are to retain talent and integrate talent management with business strategy and deal with the demographic reality, they need to democratise leadership succession planning across the entire organisation. Neither the CEO nor the organisation will succeed without an exceptional leadership team in place.

Two critical elements are required in selecting a suitable leader. An effective process of succession-planning and fully engaging board of directors are vital to selecting the right leader. The process must be comprehensive and it must include a long-term understanding of candidates' records, references, leadership style and values under various conditions and in different roles.

Develop a bespoke profile of the required future leader that is linked to the organisations strategy.

By matching person requirements to the organisation's corporate strategies this will ensure that the right person is identified during the planning stage. The organisations business model, culture and strategies should be used as standards to assess and develop potential hires.

If the existing leader has been highly successful and demonstrated effective competencies, find these out in order to determine which factors are required.

Conduct a workshop with the existing leader to identify which key attributes and capabilities have made them successful in their role. The exercise will provide valuable insights which can be used in developing the future leader's role profile. This also provides the foundations of a transition map for the newly appointed executive to follow and build upon.

Involve the board early. Engage all top level executives in interviews and succession planning.

A key component of the talent pipeline process is for directors to have access to internal talent, both informally and formally and on a regular basis. Schedule regular board meetings which are devoted to discussing succession planning and talent development issues. This allows for internal talent to be indentified early on and developed. It should be noted that organisations should not just rely on their CEO to provide talent information, but also lower level leaders.

The CEO doesn't have exposure to the entire workforce and their individual capabilities, departmental management need to feed talent information upwards. That doesn't mean that directors have to become talent managers, but it does require them to take responsibility for assisting the organisation in ensuring that talent development and assessment processes are in place.

If succession planning is to work, it must be ingrained in the culture of the company. If it is not made a priority and a part of the culture, the likelihood is that the company will simply engage in reactive, replacement planning. For example, the CFO announces that they will be retiring in twelve months.

An organisation where planning and development have not been a priority will begin planning for the CFO's successor and may even think this is in and of itself succession planning. In reality, all that the organisation is doing is reacting to the announcement and finding a replacement in advance of the retirement.

Organisations that have made succession planning a priority at all levels, however, will have already taken steps to groom potential successors, putting them in a far better position when the CFO announces their retirement.

Focus on Career Development

Have systems in place to enhance career development. Provide the identified employees with opportunities to learn from their superiors. The more information they are given today, the less difficult a transition in the future.

- Put a mentoring programme in place, it's an excellent way for less experienced staff to learn from senior employees.
- Involve the employees in cross functional projects where possible. They gain more credibility by getting to know other areas of the business.
- Be honest with the employees about their development. If they are going to be ready for a promotion they need to know what weaknesses need to be addressed through external coaching.

Develop a leadership planning roadmap

The roadmap will typically incorporate factors such as internal candidate assessment and reporting to the board, candidate's exposure to the board and development programmes, outside candidate identification and search criteria, selection touch points and an assimilation transition plan. The roadmap ensures that the CEO and board are moving forward at all times to ensure successful succession planning is achieved.

5. The Succession Transition

CEO Example

Over the last decade, CEO turnover has increased by over 50%, and performance-related departures by over 300% with nearly a one-in-three chance of a CEO being forced out for poor performance. Whilst careful and considered succession planning is critical, it is more important than ever to plan and execute a successful transition to give that succession a strong start and the best chance of success.

A solid transition can span a full year and a suggested five phase plan would include:

Begin intensive knowledge sharing.

The outgoing and incoming CEO meet frequently for in-depth discussions regarding the operating styles, histories and expectations of board members and senior management, as well as other stakeholders.

Communicate with stakeholders.

Following this briefing period, the incoming CEO should be introduced to the company's stakeholders in a series of information-gathering sessions. This allows the outgoing CEO to gracefully pass the baton and for the incoming CEO to build support and goodwill with various key players, especially those he or she has not dealt with before.

Develop a written transition plan.

With the involvement and support of the senior management team, a detailed timeline is then developed to provide the orderly transition of roles and responsibilities. If the appointment is an internal promotion, this includes the elevation of the executive who takes over the new CEO's former position.

Share the transition plan.

The plan needs to be effectively communicated internally and externally to project a sense of stability and positive perspective. Appropriate recognition of the outgoing CEO is an important component; failing to show appreciation for an outgoing leader's legitimate accomplishments risks alienating his or her supporters in the company and on the board.

Strengthen relationships with the board.

Even if the new CEO is known to the board, it is important that they begin to relate to him or her in the new role through one-on-one meetings. If the new CEO is appointed from within, he or she can begin to be phased into board meetings over a period of time. To the extent possible, the lead director should provide coaching and feedback to his or her successor throughout the process.

6. Rialto Succession Transition Solutions

Rialto partners with leadership teams to develop and strengthen talent organisational capability, maintaining stability and increasing engagement whilst upgrading capability and performance across all key functional areas through a succession talent pipeline to address future leadership and business challenges.

We assess performance and development imperatives from both an organisational and individual perspective ensuring successful succession planning and capability alignment is achieved.

Key components of a Rialto succession solution programme would include:

- Creating a shared understanding of a future high performing culture, enabling current and future high potential talent to deliver their best performance.
- Reinforcing the organisation's strategic imperatives and the 'Purpose and Ethics' principles to gain a shared group understanding of the business as it is in the existing climate and with a commitment to the vision in the future.
- Identification and validation of talent with the potential and appetite to become outstanding executives who demonstrate a commitment to personal development and exposure beyond their own discipline.
- Ensuring that all team members, at all levels have the basic core skills needed to perform in their unique roles and the ability to embed required behaviours to suit new business contexts and challenges.
- Engaging with each leadership team member to fully understand core and professional/technical skill levels and career expectations/aspirations.

- Facilitating teamwork and shared learning to build motivation and engagement towards full participation in realising an organisations vision and business results.

- Growth of cross-functional working through coaching, mentoring and the development of a high performance structured learning environment.

- Creating an organisation committed to individual progression, through leveraged engagement and development opportunities.

7. Acknowledgements

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- Nandini Rajagopalan, of the University of Southern California's Marshall School of Business
- Harvard Business Review
- Coynes Study

Rialto specialises in unique change management and transformation solutions which deliver exceptional results. We provide a range of services and interventions associated with the entire people agenda .

Our services include:

Transforming the Performance Culture

Executive and Leadership Coaching

Outplacement for Senior Executives

Outplacement and Career Transition

Executive Search

Interim Management

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