Succeeding at succeeding yourself

A synthesis of best CEO succession practices in 12 leading U.S. corporations.

BY DENNIS C. CAREY AND DAYTON OGDEN

MANY OF US are so caught up in the day-to-day events in our lives that we don't make time for those things that are necessary to ensure the future. Successful professionals with young dependents and significant assets frequently don't find the time to write a will or update it properly to guarantee that their estate and guardianship of loved ones are handled according to their wishes when they die.

Similarly, and despite the many lessons of the past few years where CEOs have died suddenly, been recruited away, performed inadequately, or failed to ensure succession when they retire, many boards still do not tackle CEO succession in a continual and systematic fashion. Yet no responsibility is more important to a board and the CEO than to ensure an uninterrupted flow of capable leadership.

Among those companies with succession plans in place, it is often assumed that succession will be an orderly process that unfolds over time. But experience tells us that succession must often be accomplished quickly and in an air of crisis. When the leader of a company dies without warning or leaves abruptly, the ripple effect on Wall Street and inside the company can be significant and costly.

In order to get a closer look at effective CEO succession planning, we interviewed CEOs and human resources executives at a dozen leading U.S. companies (Caterpillar, Continental Grain, CPC International, Foster Wheeler, GTE, Hercules, Hewlett–Packard, Mellon Bank, MetLife, Mobil Corp., SmithKline Beecham, and Sunbeam) about their "best practices."

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These companies were carefully selected after interviewing numerous directors and CEOs about their process, and reviewing nominations for the Board of the Year Award sponsored by the Wharton School at the University of Pennsylvania.

The following characteristics and approaches emerged among the participating "best practice" corporations:

1. *They have strong involved boards.* Companies that are effective in succession planning have boards that are deeply involved in the process with the CEO on a continual basis.

2. *They continually expose their top management team to the board.* Companies that are effective in succession have CEOs who provide regular and meaningful business and social exposure of potential inside candidates to members of the board.

3. *They encourage "next-generation CEOs" to gain exposure to outside board service, to the media, and to the investment community.* Companies that are effective in succession provide opportunities to the top-tier executives to serve on a few outside boards and to be exposed to investment analysts and other opinion-makers on the Street and in the media. This helps to shape their understanding of the proper relationship between board and management, and the forces at work outside the company.

4. *They form executive committees or "Offices of the Chairman" to facilitate the development of several executives who are aware of challenges, business plans, and strategies across the entire organization.* Companies that are effective in succession have CEOs who develop small teams of insiders who become "interchangeable" through cross-training and continual exposure to the entire business.

5. *They view succession planning as an ongoing and "real-time" process.* Companies that are effective in succession planning have boards and CEOs who communicate regularly (at least one or two times yearly) on a formal basis on the issue of who would likely be in line to take over

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in the event of a crisis. These discussions are linked to the strategic planning process to ensure a fit between where the business is going and the skill of the "next of kin."

6. *They take as much of the human drama out of the succession process as possible.* Companies that are effective in the succession process try to build in as much predictability for the outcome as possible. By encouraging a team approach to the leadership of a corporation, and reducing "horse races" between top contenders, there is less risk of losing valuable top executives when the successor is named. It is also common to aggressively "handcuff" the top team to discourage defections when emotions run high before this critical period.

7. *They link the CEO's compensation to the development of succession plans.* Companies that are effective in succession have boards that require the CEO to report regularly on succession planning activities with various contingency plans and formally link this to their bonus opportunity. Some corporations are beginning to attach a specific formula (up to one-third of total bonus opportunity) based on their success in this area.

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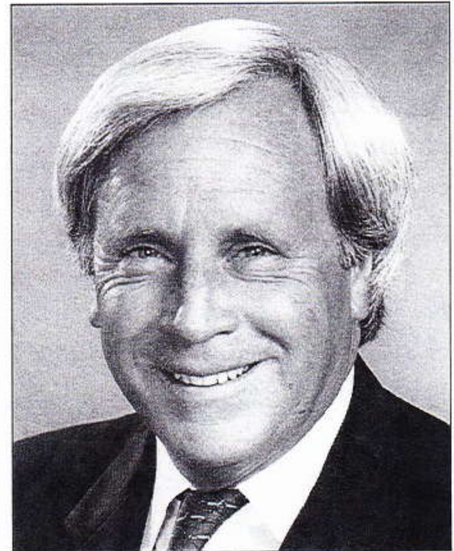
— Dennis C. Carey

8. *They pay their directors increasingly in stock and require directors to make a personal investment in the company.* Some companies that are effective with succession are guided by a philosophy that directors take succession more seriously when their own economic interests are at stake. This is achieved, they argue, by requiring directors to purchase "significant" equity in the company.

9. *They periodically calibrate likely internal candidates for CEO against comparable outside leaders.* Companies that are successful in succession planning have systems in place to develop "market intelligence" on outside candidate possibilities on an ongoing basis to ensure that the best possible leader is tapped from the broadest possible universe. This process is especially important in those companies undergoing substantial change where outside experience may be critical to execute a new strategy or to change the momentum or direction of the business.

10. *They develop a "succession culture."* Companies that are effective in succession not only take CEO succession seriously but have boards and CEOs that require all levels of the organization to plan for the inevitability of change. Some of these organizations have developed matrices for succession involving dozens of top executives and "high potentials" to ensure that they are given the proper tools, exposure, and training to develop into contenders for advancement.

Boards and CEOs that fail to develop a successful plan, or are faced with crisis if events don't conform according to plan, are often forced to pursue other, and perhaps more risky, options. One such option is the tapping of an outside director of the board to serve as an interim or permanent solution. This has become more frequent in recent years but raises some troubling issues regarding the proper role and expectations of directors in their capacity as outsiders.



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— Dayton Ogden

We are also witnessing an increasing number of companies that appear to be, perhaps unwittingly, using mergers with another company to address CEO succession. If true, this raises a whole series of interesting questions regarding the role of a board and CEO in facilitating certain transactions.

There is little debate that CEO succession is one of the most important responsibilities of a board of directors and the CEO. However, we have found that many boards have failed to address this issue in a systematic fashion. By examining the practices of some of the nation's leading corporations in this area, boards that have yet to tackle this head-on now have a benchmark against which to evaluate their own plans. One thing is for sure — the day will come when, analogous to our will or estate planning preparation, we will either be leaving our loved ones in the lurch or in the comfort of knowing that our wishes were thoughtfully carried out.

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