



## SUCCESSION PLANNING: Be proactive, not reactive.

“As management guru Peter Drucker has suggested, the confluence of a bulging aged population and a shrinking supply of youth is unlike anything that has happened since the dying centuries of the Roman empire.”

BY BRENT CAMERON

### INTRODUCTION

Succession planning has the potential to be one of the major business issues of the coming decade. The demographic reality is that organizations will have a shrinking pool of labour from which to draw on, which will impact operations at all levels, from the receptionist to the CEO. It is this reality that has pushed succession planning – an important issue in normal times – to the forefront.

Given the demographic data, it is not surprising that this issue has already garnered a significant amount of press and even research attention. Despite this attention, study after study shows that CEOs and Boards are not spending the necessary time or effort on succession planning. For a Board of Directors, the importance of CEO succession planning is clear and acknowledged; however, these studies indicate that it continues

to be an area that is not receiving adequate attention. This problem has been exacerbated in recent years with high profile accounting scandals that have resulted in new regulations and requirements, which take up significant amounts of Board time.

At Odgers Berndtson, we see the importance of succession planning on a daily basis. The question of how organizations can best implement an effective succession planning program, however, remains far less straightforward. As knowledge around the issue grows, best practices emerge regarding the characteristics of an effective succession planning program. Of particular interest are five specific characteristics that both CEOs and Boards may find helpful in developing a successful and effective program.

- 1 Be proactive, not reactive
- 2 Make succession planning a priority, at all levels of the organization
- 3 Leverage a systematic approach
- 4 Be clear and flexible about what you need
- 5 Give potential successors a broad education

This article highlights these characteristics and how companies have successfully implemented them in the past.

### A DEMOGRAPHIC CATALYST

A significant shift in labour force demographics is already underway. Research shows that an “inversion of the age pyramid” is about to take place for the first time in history, where individuals over 65 will comprise the fastest growing demographic segment in North America. Consider that 75 years ago, 12% of the Canadian population was 55 years old or older. This percentage has increased every decade, from 16% in 1971 to nearly 25% in 2005. Statistics Canada reports



that as a result of these demographic shifts, labour force growth is likely to fall to near zero or zero. A 2006 labor market study in British Columbia reports that within the next twelve years the province is projected to have one million job openings – 60% of which will be due to retirements.

This is not an issue constrained to any one province or Canada itself. In a recent study by global consulting firm Deloitte & Touche titled, *It's 2008, do you know where your talent is?*, the authors reported that by 2050, 40% of Europe's total population, and 60% of its total workforce, will be over the age of 60. Take a moment to imagine the recruitment challenges inherent in a society where 60% of the workforce is over the age of 60. This reality has made effective succession planning all the more relevant and critical for today's organizations.

### THE COMING WAR FOR TALENT

In 1997, consultants at McKinsey & Company released the now famous book, *The War for Talent*. In it they argued that during both good and bad economic times talent is critical to the success of an organization. Through extensive research involving hundreds of companies and thousands of executives, they concluded that companies that do a better job of "attracting, developing, and retaining highly talented managers" had higher returns for shareholders.

If a "war for talent" existed in the 1990s, the situation can only become more competitive as the labour market stops growing and ages. The implication from an organizational perspective is significant, as executives begin to retire at a faster pace while the pool of replacement talent shrinks. The competition for talent will increase and the ability to fill these key senior positions will become critical for many reasons, not the least of which is the finding by the McKinsey authors that talent is the cornerstone to success.

### THE STATE OF SUCCESSION PLANNING

Given the above data, it is not surprising that succession planning has already garnered a significant amount of attention. Studies show, however, that CEOs and Boards are not spending sufficient time or resources on the issue. In a *Harvard Business Review* cover story in 2005, titled "Ending the CEO Succession Crisis", the author argues that succession planning is "broken" in North America and beyond. The article cites a study by the National Association of Corporate Directors which found that nearly 50% of companies with revenue greater than \$500 million have "no meaningful CEO succession plan". Furthermore, a study by PriceWaterhouseCoopers found that

65% of CEOs surveyed planned to leave their organization 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.

The selection of a CEO is one of, if not the most important responsibilities of a Board of Directors. While Board members are clearly aware of the importance of succession planning, the planning that does take place is often found lacking. A 2005 survey by Mercer Delta and the University of Southern California found that 30% of corporate directors said their planning for succession was less than effective. Moreover, only 26% indicated that the Board participated in the development of candidates for future positions to any great extent.

## CHARACTERISTICS OF EFFECTIVE SUCCESSION PLANNING PROGRAMS

In the face of these demographic changes and the present state of planning, what can organizations do to promote efficient and effective leadership succession? A review of case studies on best practices and literature on the topic revealed five themes that stand out with respect to implementing effective succession planning programs.

### 1. BE PROACTIVE, NOT REACTIVE

Succession planning must be proactive, not reactive. Without a doubt, in every example of a company with effective succession planning practices, the focus was put on proactive planning and management. As one author puts it, succession planning is not to be confused with replacement planning. The latter is reactive, while the former is proactive and focuses on ensuring continuity of leadership.

*"...companies that do a better job of 'attracting, developing, and retaining highly talented managers' had higher returns for shareholders."*

Proactive succession planning programs identify talent within the organization *early and often*, then focus on developing this talent. As researchers Conger and Fulmer write in a *Harvard Business Review* article, "...succession management must be a flexible system oriented toward developmental activities, not a rigid list of high-potential employees and the slots they might fill". These same authors described this as a means to "developing your leadership pipeline".

Proactive also means in advance. True succession planning is not something that can be accomplished after a person announces his or her retirement. True *planning* must take place continually and thus always well in advance. This speaks to the point that succession planning is not just about identifying a person for a specific box in the organization – it is about creating a pipeline of talent that is ready to step up into any number of more senior boxes.

*“A systematic approach must be paired with flexibility to ensure an overly rigid system does not develop.”*

#### How It's Done...

Chip maker Intel has been recognized as having a very strong CEO succession plan. In the company's nearly 40-year history, five “homegrown” CEOs have led the organization. This has been accomplished by a commitment from the Board to take both a long-term perspective and an active approach in succession management. According to an interview with David Yoffie, an Intel director and Harvard professor, Intel “discuss[es] executive changes 10 years out to identify gaps”. The Board spends large portions of at least two or three board meetings reviewing rankings of the top managers and, according to Yoffie, choosing the CEO “is the single most important role of the Board”.

## 2. MAKE SUCCESSION PLANNING A PRIORITY, AT ALL LEVELS OF THE ORGANIZATION

If succession planning is to work, it must be ingrained in the culture of the company, from the Board on down. 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 she will be retiring in 12 months. An organization 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 company is doing is reacting to the announcement and finding a replacement in advance of the retirement. Companies 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 her retirement.

The active involvement of the Board and CEO in discussing, planning, and making succession planning a priority is an important factor in successful succession planning programs.

As one researcher summarizes, the involvement of the Board and CEO “motivates participants and ensures that other members of the top management team devote time and effort to the succession planning program. Without the CEO's personal attention, [succession planning] will probably receive far less attention than it presently does in these companies.”

#### How It's Done...

Possibly under the adage “that which gets measured gets done”, Colgate-Palmolive developed a particularly innovative way of ensuring all levels of management make succession planning a priority. Colgate has a program that mandates that all senior managers must retain 90% of their staff that have been designated as “high potential” or risk losing part of their compensation.

## 3. LEVERAGE A SYSTEMATIC APPROACH

The above two characteristics, that succession planning must be proactive and a priority, necessitates a systematic approach. While succession planning is by no means a science, there are ways to systematize the identification and development of talent and to measure results throughout the organization. Just as the CFO measures financial results and Marketing Managers measure the results of advertising campaigns, so too goes the argument that measurement is critical to evaluating and understanding the effectiveness of succession planning programs. Therefore, the development of sophisticated measurement tools is necessary for a systematic approach to succession planning.

#### How It's Done...

At Dow Chemical, detailed metrics tracking key performance indicators have been instituted. The company tracks its “internal hire rate” (number of candidates promoted internally versus recruited externally) and has set 70-80% internal promotions as the sign of success. Furthermore, the company tracks its rate of attrition for high potential employees and compares it to the international attrition rate on average. “In 2000, the future leaders’ rate of attrition was 1.5%, compared with 5% globally – a sign to Dow's management that the company's future leaders are getting the developmental opportunities they want and need”.

## 4. BE CLEAR AND FLEXIBLE ABOUT WHAT YOU NEED

It is one thing to have a succession planning program, but quite another to have one that is focused on the future needs (skills, experience) of the organization. What is needed today

may be very different five years from now, especially in a technology-driven company. A successful change management executive today may need to be replaced down the road with an executive who can provide more stability and continuity. The Board and senior executive team must spend time considering the needs of the organization and developing both broad and specific criteria for use in succession planning. This should be consistently updated and refined based on the changing needs of the organization. Thus, while a systematized approach to succession planning is important, flexibility must also be present to ensure an overly rigid system does not develop.

### 5. GIVE POTENTIAL SUCCESSORS A BROAD "EDUCATION"

When examining best practices at companies such as Intel, British Petroleum (BP), Colgate, and Dow, we see a common theme in ensuring that those in the leadership pipeline receive a broad education, both within the company and outside of it. To accomplish this, high potential employees are moved around an organization, in both functional and line management roles, so that they can acquire a broad base of experience to draw upon. The risk to companies that do not broaden the experience base of their talent is that an individual who is outstanding in one function may ultimately prove incapable, or unprepared, for a larger leadership role outside of that function. Research by Mercer Delta consulting looked specifically at the issue of early CEO failure and found that although these new CEOs may have had excellent track records in their specific functions, they were unable to manage relationships in broader contexts or mobilize the organization to effectively execute. Had these executives been tested in contexts outside their core areas of strength, these deficiencies may have been spotted and corrected before problems arose.

#### How It's Done...

At BP, high potential employees are developed and nurtured long before their potential transitions to significant senior roles. They are sent on two-year assignments in different parts of the company, take executive development programs at Stanford or INSEAD and depending on their success, serve as assistants to senior vice presidents to learn first-hand what is needed in these very senior roles.

In contrast, two high profile succession failures can be found in Coca-Cola's hand-off from Robert Goizueta, who served as CEO for 16 years, to his right hand CFO, Doug Ivester; and, the

promotion of Mattel's head of marketing, Jill Barad, to the top job. Despite stellar track records in their respective companies, both failed in the top job and were ultimately fired in a short period of time. Researchers Conger and Fulmer argue:

*"Ivester and Barad failed, in part, because although each was accomplished in at least one area of management, neither had mastered more general competencies such as public relations, designing and managing acquisitions, building consensus, and supporting multiple constituencies. They're not alone. The problem is not just that the shoes of the departed are too big; it's that succession planning, as traditionally conceived and executed, is too narrow and hidebound to uncover and correct skill gaps that can derail even the most promising young executives."*

### CONCLUSION

The demographic changes that are already starting to affect the Canadian and global labour markets will only increase in magnitude in the coming decades. Succession planning in its own right is an important issue; however, the issue is heightened given the demographic realities. Studies have shown, and intuition would tell us, that organizations with talented people perform better than those without. Organizations with leaders perform better than organizations with no leaders. With talented leaders retiring at an ever-faster rate and fewer people coming up behind them to take the reigns, companies that have not established a culture that prioritizes succession planning will find themselves at a competitive disadvantage. Firms that must rely on external recruitment during a transition in leadership will find smaller and smaller pools of qualified, talented executives and increased competition for these same executives. Developing a pipeline of talent is an important safety net. The best of all worlds is to have a strong pool of internal talent that can be benchmarked against a strong pool of external candidates. Organizations in this situation will have the benefit of choosing the right person at the right time. Without discipline and focus on succession development, however, organizations put their very futures at risk, as they will be relying heavily on an ever shrinking and more competitive environment for talent. Organizations that do invest in this area, however, will be better positioned to thrive in the face of upcoming changes.

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