Corporate Governance

How The SEC Just Changed Succession Planning: Part II

Stephen A. Miles and Nathan Bennett 11.18.09, 4:04 PM ET

This is the second part of a two-part article that began here. In the first part, the authors discussed how the burden on boards to oversee comprehensive, effective succession planning is growing, and they identified and discussed the first two of four questions every board should be asking as they consider their succession planning program: What does our next CEO look like? And, Where is our next CEO now--and where are two more? Here, questions three and four.

Question No. 3: How do we begin to develop our next CEO?

Once the board has identified the experiences, skills and competencies the next chief executive officer will need to possess, the next step is to get a baseline assessment of all internal candidates. Because a robust plan is deep in its reach, we encourage boards to be expansive in the number of executives they consider. Not only does being inclusive help prevent a rigged race; it also can uncover someone talented who otherwise might not have been noticed.

Also, succession planning needs to think several leadership generations ahead, so identifying candidates now for possible succession down the road is very worthwhile. Given the short average tenure of CEOs (a recent study by the human resources company Drake Beam Morin found that nearly two-thirds of a sample of 476 large global companies had replaced their CEOs in the previous five years) and the complexity than can be involved in preparing a strong candidate, there is no question that thinking five, 10 and 15 years out can make sense.

Ultimately, a good succession planning process creates a leadership pipeline filled with viable internal candidates who can overcome the commonplace presumption that a company's own people aren't good enough. There are several steps boards and CEOs can take to develop good internal candidates. First, any potential successors must have access to and meaningful engagement with board members. Meaningful engagement goes far beyond simply placing the candidate in the room during a meeting or letting him run a PowerPoint presentation. They require the candidate to demonstrate his communication skills and, more broadly, his leadership, strategic and operational acumen.

Some board members have developed a practice of holding informal one-on-one chats with candidates to get a deeper sense of their understanding of the business. Other board members have made it a habit to drop in to see candidates in action when those candidate's teams have offsite meetings. We encourage board members to find ways to spend one-on-one time with succession candidates outside the boardroom, to develop broader, fuller understanding of those candidates' thinking about both their specific functions and the entire company.

Beyond these efforts, investments in formal assessments to evaluate each candidate's strengths and weaknesses, to develop professional development plans and to then provide for coaching arrangements to execute those plans can be powerful. When the board and CEO, rather than the executive in question, are the client, feedback resulting from assessments and coaching can be shared with them and be put to use in monitoring and stress-testing succession plans.

Question No. 4: What else do we need to do as a board?

A succession planning process sturdy enough to satisfy shareholders and other stakeholders ought to make clear the actions a board is taking to prepare for succession, and even to deal with circumstances as dramatic as the events at McDonald's (see Part I of this article). Therefore, you need to do these two things:

1. Develop the board's capabilities in succession planning.

Because CEO succession is a rare occurrence, few boards are practiced at it. But a board interested in building shareholder confidence will want to find ways to demonstrate that it's fully ready to handle a succession, and to handle it well.

Since dealing with succession usually falls to a board's nominating and governance committee, begin by considering who the board appoints as committee chair. A chair who has been involved in succession before, as an incoming or outgoing CEO or as a board member, may add legitimacy to the board's process. On the other hand, having an inexperienced person in this critical role can increase the perceived risk in the process. As boards think about the competencies they want among their members, they absolutely must look for experience with succession itself, not just with succession planning. Just as Sarbanes-Oxley made it blazingly clear that audit committee chairs better be on their game, the new Securities Exchange Commission bulletin reinforces the importance of capable nominating and governance committee chairs.

If the nominating and governance committee is steered by a leader truly experienced in succession, it can more easily attract the strongest members of the board. Recognize that CEO succession is an integral and increasingly important board responsibility in this era of greater transparency, and you'll make serving on the committee even more appealing to the board's best strategic thinkers.

In addition to developing board member capabilities regarding succession planning, boards should be open to the savvy use of external advisers. Just as many boards now rely on outside consultants to advise their compensation, audit, strategy and other committees, deep and useful expertise in succession planning can also be drawn on from outside the confines of the board too.

Why would a board choose to go it alone, without the help of people who are truly practiced at identifying and selecting CEO candidates? It's a hugely important decision, yet the rarity of the event means that few board members can be expected to have deep multi-company experience in the area or to know how to calibrate true CEO performance and potential. They typically draw on their own experience within one company or industry only. Moreover, because this kind of assessment isn't truly quantifiable the way compensation or audit is, people can easily believe they're somehow expert to their own detriment and the company's peril. The use of an external strategic adviser on succession and selection is slowly becoming a best practice, as more and more boards seek guidance and input.

Finally, in too many instances we see the succession plan become something that the CEO and the head of human resources present annually *to* the board. Instead, a robust process starts by engaging the board in the development of a forward-looking skills and experience profile for the CEO. The resulting document should be continually updated to accommodate changes in strategy and other developments. It should go beyond just describing the job to delve deeply into both the competencies and the experiences the next leader will need to have. It can then be translated into a dashboard for grading succession candidates objectively.

By engaging the board first in setting the criteria and then in refreshing them each year, you create buy-in and alignment among the jury that will select the next leader. Also you force the decision-making body to think long and hard about what will be required of the company's next leader. That allows a fresh look at the company, and it should keep the board engaged and leading the process, year in and year out--not just when there is a crisis forcing it to spring into action.

2. Stress-test the board's plans.

A regular part of any healthy succession planning process is stress-testing of the plan itself. This involves board members anticipating a conversation like the one that opened Part I of this article. How would that conversation evolve from where we left it? Is there a viable emergency candidate who can serve temporarily as the process goes forward? The candidate may be a member of the C-suite or may be a member of the board; he or she is unlikely to be anyone else. Furthermore, the board needs to be able to answer these questions:

--Do we understand the experiences, skills and competencies we need our next CEO to demonstrate? And do we have the process in place to continually revisit and evolve this understanding as circumstances dictate?

--Do we have a consensus about who we can invest in today so they will be prepared tomorrow?

--Do we evaluate these candidates at least annually on each of the dimensions above?

--Have we worked to understand the external market, so that a scan will quickly reveal outside candidates we might want to include in the mix?

--Have we pushed the company to develop a team strong enough to help manage the risk associated with bringing on a new CEO?

--Is there in place a seasoned chairman or lead director who is able, willing and available to coach and mentor a new CEO?

Each "yes" answer to a question above reduces the risk to shareholders described in the SEC bulletin. When the answer to every question is an unqualified "yes," the board can generally feel confident that it has in place the requirements for a robust succession planning process. Of course, the ongoing challenge is to be able to answer affirmatively each of these questions every day.

One caveat: Just because a board has gotten one succession right doesn't mean it will all go so well the next time. Accidental success can lead to overconfidence. Even if your board can answer "yes" today to all the key questions above, can it sustain the same level of preparation and process in a changing economy, market and regulatory environment?

Remember that the goal is a succession planning process, not merely a succession plan. That is what you need to make sure your succession risk is managed today, tomorrow and in the future.

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