Forbes.com

Leadership

Succession Planning: How Everyone Does It Wrong

Stephen A. Miles 07.30.09

CEO transitions are risky times for companies. When the departing chief executive officer has had a strong run, there is worry about his successor's ability to maintain the momentum. When he has performed poorly, there's anxiety about whether and how fast his successor will be able correct course.

In the current economic climate, CEO turnover can cause even greater tensions for both internal and external stakeholders--especially if some of them are blaming the existing boss for leading the company down the wrong path.

One reason it's all so difficult is because transitions historically have not been well done. When there's an internal succession, too often the outgoing CEO has had the largest--or only--influence on the process. He (or she) has too often made one of two mistakes, either choosing someone in his own likeness when what the company really needed was someone different, or choosing someone of lesser stature to preserve his own legacy. When a board has been able wrest control of the succession from the CEO, it too often has instantly gone outside to recruit someone from another company. That is often an overcorrection. Very able candidates may exist inside. And they may present much less of a risk than an outsider.

The practice of vetting and selecting potential successors has come a long way in recent decades. Cases of a departing CEO anointing his own hand-picked successor used to be common; they're now very much the exception, except when the CEO is the company's founder. Succession has come to be seen as a board of directors' most critical responsibility, with the CEO just one participant in the process (although handling his role can be a sensitive issue).

Of course, having a succession plan is easy, and few companies in the era of the Sarbanes-Oxley Act of 2002, with its detailing of board

responsibilities, would acknowledge they lack one. The challenge is to have a plan adaptable to the dynamic nature of the succession process and the shifting demands on the CEO position. And as with any other sort of plan, the hard part is actually executing it.

At the 1,000 largest American companies (by revenue) in 2008, 80 new CEOs were appointed, and only 44 of them--55%--were promoted from within. If you view a board's having to go outside to hire a CEO as a failure in succession planning, that represents a breakdown in the system. A failure rate of 45% means that far too many plans aren't working.

Why aren't they working? In my experience, board members too often fear they can't find a truly viable successor inside the company. This can result from a lack of exposure to internal candidates and a subsequent lack of true understanding of what those candidates are capable of. The board may simply be unfamiliar with anyone not close to the CEO's office. The CEO may be optimistic about a successor he's grooming while the board hasn't had the chance to develop confidence.

These observations point to a critical area where succession planning practices can and should be improved: The CEO and the board need to get and stay on the same page when it comes to the true readiness of internal succession candidates and making sure of their preparation.

Furthermore, CEOs and boards need to overcome the following myths about succession planning.

--External candidates are more exciting and promising. There is a paradox in succession planning: Internal successors are in many ways lower risk than outsiders, yet surprisingly few promotions are awarded internally. That appears to be because boards often prefer the devil they don't know to the devil they do. Also, some find it difficult to imagine someone at the top after seeing him operate in a lesser role for years. Meanwhile internal candidates hear over and over that they are still just a year or two away from being ready.

--The successor has to be ready now. The concept of the "ready now" executive is not useful and should be stricken from the business lexicon. If a company did manage to make a "ready now" successor, the only way it would know would be after the fact--perhaps when that candidate was running a competitor because he tired of waiting. Such executives often end up doing very well somewhere else, proving that there actually was a viable candidate all along that the company was ignoring.

Just how "ready" each executive needs to be depends in part on certain characteristics of the rest of the top management team. One client of ours, a very large business, was looking externally for a new chief financial officer but ultimately decided on a young internal candidate, in his early forties, who had never served as CFO at a public company. The risk that the candidate would not appear "ready" was lessened by the facts that the current CEO was a former CFO and there were a world-class treasurer and controller already in place. In the end, the particular context of a leadership situation goes a long way toward determining how "ready" the successor needs to be and, consequently, how much risk the decision-makers may want to accept.

---CEO succession planning is single-person event. When boards take on succession planning, they often focus on the CEO role--the role that gets the most attention in the media and in the marketplace--to the exclusion of other positions. But the best succession planning really involves a constant assembly and reassembly of a leadership puzzle with many pieces. In fact, the pieces themselves aren't of constant shape or size. As each piece is selected--from CEO, CFO and COO to sales and marketing chiefs and other C-level officers--the shape of the remaining pieces becomes clearer. And external factors such as company strategy, economic conditions and the like also affect the way the puzzle is solved.

The choice of the best candidate will depend partly on the team surrounding him or her and how all their skill sets complement one another. A trend we are seeing develop in the best managed companies is that boards aren't satisfied with an externally calibrated view of just the CEO and his or her direct reports. Now boards want a similarly detailed measure of all the executives one or two levels below to see who's on deck and how deep the talent bench is. That greatly helps in succession planning, as executives gain exposure to the board much earlier.

--What worked in the past will work in the future. When a board is planning to replace a legendary, or even merely successful, CEO there is a strong danger in framing the process by looking in the rearview mirror. What a company needs in the next six months and beyond may be drastically different from what was needed even in the last quarter. An individual who sees the company and its industry through a new set of lenses may be best prepared to recognize and seize new opportunities. Jamie Dimon was markedly different from Bill Harrison at JPMorgan Chase, as was Marius Kloppers from Charles Goodyear at BHP Billiton. All four leaders have been successful--but each successor was quite unlike his predecessor.

It is critical that boards define the skill sets, expertise and character required for the next CEO by taking into consideration today's company needs. This is particularly relevant in the current market, which will test the succession plans of just about every company. The preferred candidate of six months ago may no longer be such, given a dramatically different business environment.

·--*We have a great internal candidate. We don't need to look outside.* As I mentioned earlier, some companies automatically view external candidates as more attractive. But others remain myopically focused on their own people. Having a viable internal candidate doesn't ever excuse the succession planning process from looking outside to ensure that the best candidates for the job are considered. Boards increasingly run inside and outside searches concurrently. It is simply good governance, and shareholders should mandate it.

The tricky part of it all is communication, particularly with the internal candidates. Not being transparent about opening up the search for a successor to both outside and inside parties can do damage internally; people need to be informed upfront of how the process will run. Active management and communication of the whole effort is critical, and when done well it can leave the internal, if selected, feeling they were the very best candidate, period.

What the best companies do is first conduct an external market scan that identifies the key candidates within the industry, then find the adjacent and best athletes across industries, and finally roughly compare all those candidates to their internal ones, using the same forward-looking skills and experience criteria. Most often we see selection committees narrow the list to two or three external candidates that they engage and interview. If the external candidates are not dramatically better than the internal ones, companies take into account a certain transition risk, the external process is stopped, and the selection is completed internally.

Stephen A. Miles is a vice chairman and the managing partner of leadership advisory in the Leadership Consulting Practice at the executive search firm Heidrick & Struggles.