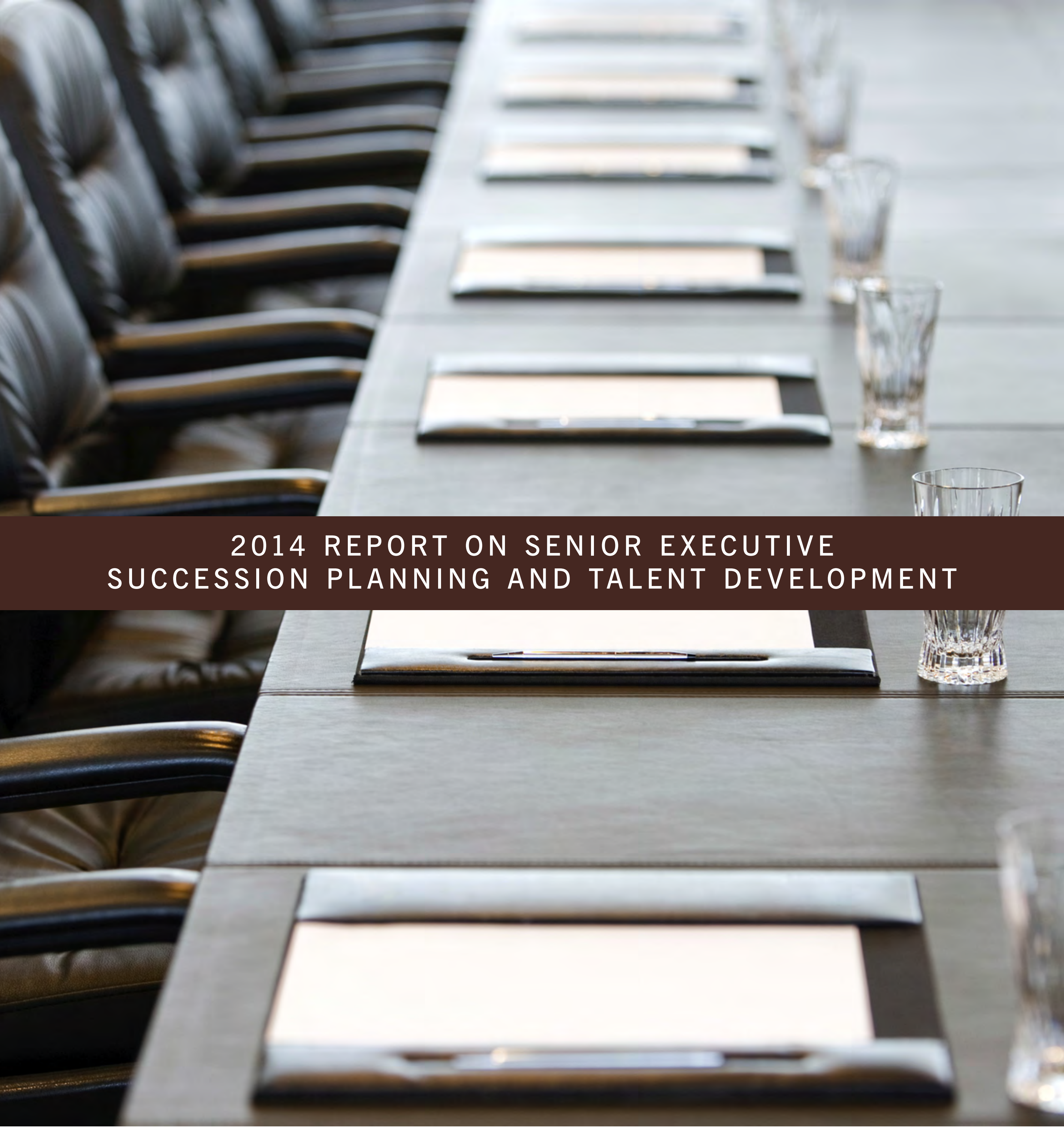

2014 REPORT ON SENIOR EXECUTIVE SUCCESSION PLANNING AND TALENT DEVELOPMENT

IED The Institute of Executive Development

ROCK CENTER FOR CORPORATE GOVERNANCE STANFORD UNIVERSITY

STANFORD GRADUATE SCHOOL OF BUSINESS

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Executive Summary

A Steep Hill to Climb

"The corporate leaders we interviewed all believe that succession is vitally important today, just as it has been in the past," said Professor David Larcker of the Stanford Graduate School of Business. "Still, the majority do not think that their organizations are doing enough to prepare for eventual changes in leadership at the CEO and C-suite levels, nor are they confident that they have the right practices in place to be sure of identifying the best leaders for tomorrow. These findings are surprising, really, given the importance that strong leadership has on the long-term performance of organizations. Research shows that companies with sound succession plans tend to do better."[1]

"Most company directors greatly underestimate the difficulty, time, and cost associated with CEO and C-suite succession planning," adds Scott Saslow, founder and CEO of The Institute of Executive Development. "They fail to recognize the need for a strategy for this critical business process, they haven't had great exposure to what other organizations are doing, and they haven't thought through what their own organization should be doing given its unique set of circumstances. This is more than lost upside opportunity. It puts many organizations at risk of having unstable executive leadership."

In the fall of 2013, The Institute of Executive Development and the Rock Center for Corporate Governance at Stanford University conducted in-depth interviews with executives and directors at 20 companies regarding their succession and executive development practices. Key findings include:

- **Companies do not know who is next in line to fill senior executive positions.** Organizations often do not make the connection between the skills and experiences required to run the company, and the individual candidates—both internal and external—that are best-suited to eventually assume senior executive positions. When a list of possible successors is compiled, it is too often narrow in scope and therefore not relied on when a succession event actually occurs.
- **Companies do not have an actionable process in place to select senior executives.** Companies recognize the importance of a thorough and rigorous succession process for both the CEO and senior executive positions; however, most fail to create one. The problem tends to be cultural: the majority of companies do not have honest and open discussions about executive performance, nor do they allocate sufficient time to the process of identifying and grooming successors.
- **Companies plan for succession to "reduce risk" rather than to "find the best successors."** Succession is fundamentally a preparation exercise for the future. However, respondents are more likely to view this activity in terms of its potential to reduce future *downside* risk rather than producing shareholder value benefits from the identification of strong and appropriate leadership. This is due in part to the scrutiny of regulators, rating agencies, and other market participants that emphasize the risk management and loss minimization aspects—rather than value creating elements—of succession.
- **Roles are not defined and often they are not followed.** Companies agree that succession planning involves the combined efforts of the board of directors, the senior management team, and support staff such as the human resources department. Most, however, do not structure an evaluation process that formally assigns roles to each of these groups and requires their participation. Furthermore, the key performance indicators of an executive's performance often do not measure his or her effectiveness in grooming and mentoring direct reports. There are few organizational metrics in place to determine how well the company is managing succession overall.
- **Succession plans are not connected with coaching and internal talent development programs.** Succession planning and internal talent development are treated as distinct activities rather than one continuous program to gradually develop leadership skills in the organization. Because of this, the board of directors does not have sufficient insight into the skills and capabilities of the senior management team and is not prepared to determine which executives are most qualified to replace an outgoing CEO or C-suite member when a succession event occurs.

1 See: Bruce K. Behn, David D. Dawley, Richard Riley, and Ya-wen Yang, "Deaths of CEOs: Are Delays in Naming Successors and Insider/Outsider Succession Associated with Subsequent Firm Performance?" *Journal of Managerial Issues* (Spring 2006).

To improve organizational succession and talent development programs, Mr. Saslow and Professor Larcker recommend the following:

1. **Map the future operating and leadership skills required of each executive position and benchmark executives against these skills.** Each position in the senior management team, including the CEO, requires a set of skills and capabilities that is related to its scope of responsibility and relationship to the organizational strategy. Executives should be evaluated not only in terms of their ability to achieve the requirements of their current role, but also in terms of their potential to assume different or larger roles in the organization. When holes or deficiencies are identified, plans should be put in place to rectify them, such as focused executive development activities or job rotation.
2. **Cast a wide net.** Because an organization and its strategy are constantly evolving, the skills needed to run the organization in the future might not be the same as they are presently. Executive talent should be evaluated in terms of its ability to meet future—not just past or current—needs. To this end, the board and senior management should look broadly through the ranks of the organization to ensure they are fostering a diverse set of talents and skills to take the organization forward. Internal executives should be benchmarked against the external market for talent.
3. **Be comprehensive and continuous.** Succession is not episodic. It should be treated as a continuous practice whereby management and the board prepare for transitions at any time and at multiple levels throughout the organization. This includes not only the CEO position, but also his or her direct reports and other critical positions. Contingencies for these positions should be continuously maintained. Succession is more time-consuming, riskier, and more expensive when carried out following a departure rather than in advance.
4. **Assign ownership and roles.** One of the biggest reasons that organizations fail at succession is that they do not assign ownership and accountability to the process. An independent chairman or experienced outside director should have primary responsibility. Other board members, the CEO, senior executives, and support staff should be assigned specific roles and held accountable for measurable results.
5. **Connect CEO and senior executive succession plans with coaching and internal talent development.** These programs are not isolated but instead strategically support one another. The only way to have a robust and reliable succession plan is to map succession to the pipeline of internal executive talent, identify deficiencies in internal talent, and design and implement development plans to overcome these.
6. **Assign coaches and mentors.** Professional third-party coaches bring an outside perspective and degree of objectivity to the development process. They also allow for executives to grow outside of the chain-of-command of the company's formal reporting structure. Similarly, board mentors can give senior executives a new perspective on the organization while at the same time providing the board with greater insight into organizational performance.
7. **Get strategic assistance when necessary.** The best organizations understand their relative strengths compared to peers and seek to learn from the practices of others. Companies should survey the practices of other corporations and integrate the ones that are best suited to their current structure and situation. It is always a good idea to obtain data on how your processes and executives compare to those at other firms. Each company's succession plan will be customized to take into account its specific competitive situation, depth of talent, and future strategy.

Review of Findings

1. **Companies do not know who is next in line to fill senior executive positions.**

- Organizations understand the skills and disciplines that are core to their organization. However, they often do not make the connection between these skills and the senior executives who are potential candidates to succeed the CEO and other C-suite executives.
- Leadership skills and expertise are not routinely mapped to executive positions, and current senior executives are not benchmarked against a required list of skills. When benchmarking occurs, it tends to be on a "one-off" basis rather than comprehensively and continuously assessed for the entire senior executive team.
- Organizations cast a wide net to identify the best successor candidates. Respondents indicate reviewing several dozen executives to find a handful of viable candidates.
- Companies are reluctant to be transparent with internal executives about whether they are included on the list of possible successors and about "over investing" in these executives, as this might lead to the premature departure of capable executives who are not on these lists.
- Greater diversity is desired among senior executive teams but achieving that diversity remains a challenge.
- Approximately 25 percent of organizations choose outside CEOs rather than insiders. This trend is viewed by some respondents as a failure to produce adequate successors internally.
- Some boards believe it is simpler to choose an outsider because the company can outsource the succession process to a recruiting firm who will source candidates, conduct assessments, and facilitate a recommendation.

In Their Words

"The board agonized for two years over whether to fire the CEO, but we didn't have a successor in place. It's a very tough decision because it takes three months to put a new person in place, at least."

"The CEO quit unexpectedly and we didn't have a successor lined up. Sometimes you have to promote an executive to CEO role earlier than you otherwise would…. We always had discussions about who the stars were, how to develop talent, but we didn't have a fixed succession plan that picked out a specific person."

"You need to identify 125 people to get the top five, and then plot their moves for years."

"Our company is small and we don't have layers of extra talent. In a situation where the CEO gets hit by the proverbial bus, we may be in trouble."

"We don't develop formal profiles. Each individual decision is one-off."

"We don't have a formal skills or competency model for critical positions. We rely on recruiters for that."

"One of the faults is that the same name pops up too often. If that person leaves, you have a serious gap."

Source: IED, Stanford University, 2014

Data Snapshot

Is your company grooming a specific executive to succeed the current CEO?

	Percent
Yes	54
No	46

How many candidates from the internal talent pool are "ready now" to immediately assume the CEO position (i.e., you could name them tomorrow if required)?

Candidates	Percent
0	39
1	32
2	24
3	5
4	1

If your current CEO left tomorrow, how long would it typically take for the board to name a permanent successor (in days)?

	Days
Mean	88.8
Median	90.0

Source: Heidrick & Struggles, Stanford University, 2010

2. Companies do not have an actionable process in place to select senior executives.

- Key elements of a succession plan include:
  - A shared vision of the future direction of the company
  - A skills and experience profile for the next CEO
  - A skills and experience profile for critical senior executive positions
  - Identification of top internal talent and development of a growth plan for each
  - Avoiding a "cloned culture" by identifying candidates with diverse backgrounds
  - Identification of top external candidates as a benchmark
  - Fostering a culture of executive development
  - Providing opportunities for the board to meet with and mentor promising senior executives
- Companies recognize the importance of a reliable succession plan. However, most do not believe that their company's plan is adequate, nor do they have confidence that it will necessarily produce the best successor.
- Executives and board members want to have greater visibility into the practices and activities at other organizations in order to benchmark and make improvements to their own practices.
- Very few companies report tracking metrics, and few have a sense of how other companies conduct succession planning or what the best practices are.
- Companies recognize that succession is a "multi-person event." CEO turnover has the potential to precipitate additional departures among the senior executive team, either among candidates who have been passed over, or as the new CEO assembles his or her own team.
- Some companies try to mitigate the risk of premature departure among high-performing senior executives by increasing their communication with and attention paid to this group.

In Their Words

"Most boards do not have an adequate process in place. When the company is not doing well is when you really need the deep bench, but by that point it is too late to get it underway."

"When people are looking at the effectiveness of succession planning, they should ask: is it an annual process or ongoing? What are the processes that people use to keep things going? For example, have HR meet every two weeks to talk about what VP positions are open or projected to be open. Link strategy to talent. The operating calendar starts with developing a business strategy, followed by a workforce planning or organizational capability session, then talent reviews against that."

"We have several hundred senior leaders. Each one is put into quartiles, and the top 25 percent have succession plans."

"We keep job descriptions updated for key positions reporting to the CEO. This includes the latest strategic plan, so our job descriptions are consistent with current business direction. In committee meetings, we review candidates for these positions, discuss how they are progressing, learning, developing, etc. When we can't find internal candidates, then we look externally. For some positions, we do a 'strategic hire.' We hire a person into a position that is open with the understanding that they will progress into a key role down the road."

"Culture drives how successful succession is. Closed cultures and cultures that are not 'feedback-based' don't have productive succession plans or discussions. Open and transparent cultures are much more successful. Ultimately, the CEO creates the culture and the boards are guardians of that culture."

Source: IED, Stanford University, 2014

Data Snapshot

Who on your board oversees the CEO succession planning process?

	Percent
Full Board	53
Succession Committee	3
Compensation Committee	20
Nominating/Governance Committee	20
Other	4

How often is the CEO succession plan reviewed?

	Percent
Once per year	55
More than once per year	26
Less than once per year	4
In event of retirement / emergency	13
Never	1

When the board of directors discusses succession planning, how much time (in hours) is typically allotted to succession planning?

	Hours
Mean	1.14
Median	1.00

Sources: The Conference Board, IED, Stanford University, 2014; Heidrick & Struggles, Stanford University, 2010

Best Practice Example

The following content is used by one of the study participants to guide the succession planning process.

Six Key Elements of Successful Succession Planning

1. **Strategic Planning** – Determine what capabilities, roles, and talent are needed to execute the business strategy today and in the future
2. **Talent Assessment** – Gauge the Executive team's bench strength – Do we have who we need (now and in future) and if not, how do we get there?
3. **Recruiting** – Develop a talent pipeline for key roles/jobs.
4. **Performance Assessment** – Let people know they are valued contributors and provide them opportunities for development, exposure to Executives, networking across Divisions, etc. (get them on the corporate radar screen.)
5. **Development** – Create development plans for individuals (e.g., leadership workshops, classes, on-the-job learning, assignments, special projects, 360s, external classes, etc.)
6. **Retention and Engagement** – Rewards and recognition, work environment, opportunities for development, job autonomy and scope of responsibilities, etc.

Sample Questions to Consider Before and During Meetings

1. Current Organization Structure	2. Current Leadership Team	3. Identified Successors / Replacement Plans	4. Additional Talent Pipeline
is the current structure working?	Who are your key players?	Succession plan, restructuring, eliminate job, etc.	Who are our high potentials? Focus on women and minorities
The right direct reports? Too many? Too few?	How are they doing?	Who are internal successors?	What are their performance, capabilities, potential?
Any job that isn't but should be reporting to top Exec?	What are their performance, career potential, & interests/ aspirations?	Who are external successors?	What should we do to develop them?
Any missing capabilities that we need to recruite for?	Strengths, weaknesses, development needs?	Are they ready to step up? If not, what are we doing to help develop them?	
Critical jobs?	What are we doing to help develop them?	Retention risks (if no bigger job open ups or passed over)?	
Any other structural concerns/issues?	Any retention risks?	Development thoughts/ plans?	
	Any missing talent?		

Sources: Study participant. Reproduced with permission.

3. Companies plan for succession to “reduce risk” rather than to “find the best successors.”

- Most respondents state that they conduct succession planning for risk mitigation purposes. By and large, they do not conduct succession planning because they believe there is upside in terms of organizational performance.
- Respondents cite the importance of managing external perceptions, maintaining continuity in the business, and creating shareholder value.
- Companies are aware that succession planning is subject to greater external scrutiny than it has been in the past. New constituents cited include institutional investors, the financial press, the Securities and Exchange Commission (SEC), credit rating agencies such as Standard and Poor’s and Moody’s, and proxy advisory firms such as Institutional Shareholder Services and Glass Lewis.
- Organizations are concerned that the SEC reclassification of succession planning from a “day-to-day management activity” to a “risk factor” will translate into more disclosure, public scrutiny, and discussion.

In Their Words

“If we don’t get this right, it can have a significant impact on how we are perceived by Wall Street, by investors, and by our own people.”

“Succession planning reduces the risk of planned and unplanned departures.”

“We do succession planning for risk mitigation, to make sure we have bench strength, and to develop future talent to take over the CEO role.”

“You do much to mitigate the risk by choosing an internal candidate who has been developed, groomed, and who you and the organization knows well…. There is no better way to convey competence and confidence to Wall Street than to maintain continuity with a successful internal candidate as the next CEO.”

Source: IED, Stanford University, 2014

4. Roles are not defined and often they are not followed.

- Companies with reliable succession plans involve members of the board, the senior management team, and representatives from key functional areas including human resources, manufacturing, marketing, and finance when appropriate.
- The board of directors is often accountable for top-level succession planning and participates in talent discussions. Executives review their teams and participate in cross-functional evaluations. The human resources function provides tools and success profiles, facilitates talent reviews, and tracks progression.
- While boards, executives, and human resources have distinct roles, their level of involvement varies across organizations. Many respondents claim that these three groups do not spend sufficient time meeting together. The frequency of meetings varies from quarterly, to annually, to never.
- Companies that believe that succession planning is a managerial responsibility tend to assign primary accountability to the CEO. Companies that believe it is a governance responsibility assign primary accountability to the board. In some organizations, it is unclear whether the board of directors or the CEO is primarily responsible.
- Some respondents believe it is not in the long-term interest of the company to give the CEO responsibility for identifying and developing his or her own successor.
- The board of directors does not always play a central role in succession. In some companies, directors review succession plans but do not engage directly with specific candidates, or participate in their development.
- Human resources is the group most likely to be left out of the discussion on succession. Boards and executive teams do not always see a role for human resources and do not have confidence in their ability to identify or develop talent.

In Their Words

"We have a standing executive committee composed of one board member from audit, the head of HR, and senior staff. Their job is to meet quarterly and talk about succession, supported with the performance reviews of all senior executives and information on what each is doing to move forward in the organization."

"In some companies it's board led, in others it's management led. The role of HR is not clear."

"Our board is involved but only in an advisory capacity."

"The board plays an arms-length, distant advisory role. Their role is to review and approve the plan. 80 percent of the time, they approve the plan as is; 20 percent of the time they request more data."

"The CEO drives the process, with board awareness and support."

"The CEO might consult HR, depending on the quality of the HR leader, who they are, and how much respect the CEO has for them."

"HR is more than just in the loop. They play an active role in the ongoing development of senior executives and the review process."

"HR really manages the process, keeping track of lists, dates, milestones, and inserting their point of view."

"HR is really not a factor. They aren't a strategic player in the companies I am involved with. They are more tactical."

Source: IED, Stanford University, 2014

5. **CEO succession plans are not connected with coaching and internal talent development programs.**

- At many companies, there is little or no connection between succession planning and the talent development program for senior executives. These are treated as separate activities, with different owners, objectives, processes, and resources.
- Companies that do connect succession with talent development view the integration favorably in terms of its impact on the organization and its leadership.
- Development plans for senior executives include both functional (operational) elements and interpersonal (leadership) development. Companies track individual progress using a mix of quantitative and qualitative measures.
- Challenging, on-the-job assignments are the most popular way to develop top candidates. Examples cited include job rotations, international assignments, exposure to external constituents (such as Wall Street analysts and regulators), and board appointments at other companies.
- The use of third-party, executive coaches is mixed. Those companies that rely on executive coaches report positively on the practice.
- At most companies, the board of directors does not directly mentor or advise senior executives. However, among those that do, board mentoring is highly valued by the board for the insights it provides into the organization and among senior executives who gain access to an experienced, respected advisor.

In Their Words

"Unfortunately, at our company development programs were perceived as a negative or punishment. If an executive was getting coaching, the signal was that he or she has a problem that needs to be fixed. That was not the intent, but that is how it came out."

"The board hasn't asked about development programs in over a year. Management is too insular in how they do the assessments. We need a more structured process."

"Job assignments are given great thought, especially to broaden and deepen a candidates' knowledge in certain areas. For two or three CEO candidates, we encourage them to take directorships on other boards. It gives them a chance to observe other CEOs and board interactions. Also, we send them to do presentations at conferences. It gives them exposure to Wall Street and helps them understand how to manage news and quarterly earnings."

"Sixty-five or seventy percent of the evaluation is quantitative: how well do they execute? The rest are soft skills. Every year we are one of the most admired companies in the world. We would not threaten that by promoting someone who is a jerk to work for."

In Their Words, continued

"We look at outputs of succession—not just what worked but equally important at what went wrong. We need to incorporate those lessons learned."

"We use external coaches for formal development. Internal coaching is much less defined and much less formal. Executive coaches are assigned to the top five executives in the company. They help with soft skills, leadership skills, and presentation skills."

"We have never needed a coach for the CEO."

"Board members would provide informal mentoring. We identified high potential executives and would invite them to board meetings, dinners, etc. The board would talk with them about how and what they were doing, and what they might consider in terms of development. It was done in a way that would not undercut the corporate power structure."

"The board would find an excuse to meet with candidates. Invite them to board meetings, participate in strategic reviews, or various task forces. It gave directors exposure and insight, and a chance to interact with future leaders."

Source: IED, Stanford University, 2014

Data Snapshot

Does your company have a formal talent development program for senior executives below the CEO?

	Percent
Yes	60
No	40

How well do non-employee directors understand the strengths and weaknesses of senior executives below the CEO?

	Percent
Extremely well	9
Very well	46
Moderately well	34
Slightly well	8
Not at all well	4

Do non-employee directors formally participate in the performance evaluation of the senior executives below the CEO?

	Percent
Yes	23
No	77

Does your company assign a board mentor to senior executives below the CEO?

	Percent
Yes	7
No	93

How frequently do non-employee directors meet with senior executives below the CEO without the CEO present?

	Percent
Quarterly	28
Semi-annually	1
Annually	0
When circumstances warrant	65
Never	6

Source: The Conference Board, IED, Stanford University, 2014

IED Index Data

Respondents were asked to rate succession practices at their companies in the form of statements from the IED Index using a five point Likert scale from 5 *(strongly agree)* to 1 *(strongly disagree)* scale.

To what extent do you agree with the following statements, regarding your company?

"The CEO and executive team are actively involved in succession planning and talent reviews."

	Percent
Strongly agree	27
Agree	55
Neither agree nor disagree	9
Disagree	9
Strongly disagree	0

"The board is actively involved in succession planning and talent reviews for key executive positions."

	Percent
Strongly agree	31
Agree	15
Neither agree nor disagree	54
Disagree	0
Strongly disagree	0

"There are clearly defined competencies for key executive positions."

	Percent
Strongly agree	23
Agree	54
Neither agree nor disagree	23
Disagree	0
Strongly disagree	0

"Our organization has a clear and compelling executive development strategy."

	Percent
Strongly agree	20
Agree	30
Neither agree nor disagree	40
Disagree	10
Strongly disagree	0

“The board believes there is an effective succession plan in place.”

	Percent
Strongly agree	8
Agree	42
Neither agree nor disagree	25
Disagree	8
Strongly disagree	8

“There is an adequate pool of ready successor candidates for key C-suite positions.”

	Percent
Strongly agree	17
Agree	8
Neither agree nor disagree	42
Disagree	33
Strongly disagree	0

“There is a formal process for developing successor candidates for key executive positions.”

	Percent
Strongly agree	8
Agree	38
Neither agree nor disagree	38
Disagree	8
Strongly disagree	8

“There is an adequate pool of ready successor candidates for the CEO position.”

	Percent
Strongly agree	8
Agree	17
Neither agree nor disagree	42
Disagree	33
Strongly disagree	0

Methodology

Results are based on interviews with board members and executives at 20 companies between June and December 2013. Quotes have been edited for clarity.

Data Sources

Information about the IED Index, available at:
https://execsight.com/publicpdf/ied_index_pdf_21335.pdf

Survey data is based on surveys conducted by IED, Stanford University and their affiliates, available at:
http://www.gsb.stanford.edu/cldr/research/surveys.html

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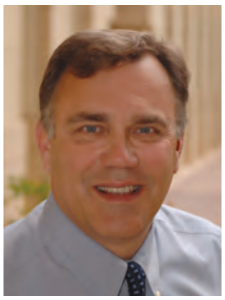

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About IED and the Rock Center

About The Institute of Executive Development (IED)

IED's mission is to drive innovation in executive development. We support business executives, boards, and talent management professionals to benchmark their practices using the IED Index, design their strategies, and create high impact executive development services.

http://execsight.com/about

About The Rock Center for Corporate Governance

The Arthur and Toni Rembe Rock Center for Corporate Governance is a joint initiative of Stanford Law School and the Graduate School of Business at Stanford University. The Center was created to advance the understanding and practice of corporate governance in a cross-disciplinary environment where leading academics, business leaders, policy makers, practitioners and regulators can meet and work together.

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