

Feature

Succession planning

Bvalco runs a regular series of debates for chairmen, board directors and company secretaries. This article is an extract from a recent debate concentrating on succession planning.

All firms must eventually experience the potential disruption of replacing the CEO, chairman and other board directors. The extent to which the succession process disrupts firm performance and share price both in the short and medium terms seems, to a great degree, to depend on how well planned and executed the process is. The statistics of smoothly run succession processes indicate that there is room for improvement. A recent study of 2,500 publically listed firms found that 89 per cent required an interim CEO for a period of more than 45 days, with interim CEOs described as being 'a last resort'.

We started our discussion considering, why is succession so difficult to do well? Succession planning implies letting go: of people, past strategy and practices. The ending can be planned, for example the end of an agreed tenure, or unplanned such as sudden illness or death. But more typically, succession happens when an ending creeps up. The awareness of the need for a change in strategic direction starts to dawn, the performance of the business becomes troubling, or there is a gradual change in personal circumstance of a board director which necessitates a change. Whichever way you look at it, succession (planned or unplanned), is a highly emotive topic which no one approaches neutrally. Considering succession raises a number of questions such as, 'am I replaceable? If I need to be replaced does that mean I am now not good enough?' As a result the natural human tendency is to avoid tabling the discussion. Even if discussion is tabled, there is often avoidance of driving the thinking through from options to firm conclusions. This dynamic of letting go is one which needs to be actively managed and worked through. Without proactive management decision taking may be delayed and may detract from the business of the board.

Is succession a transaction or a continuous process?

The UK Corporate Governance Code presents board appointments alongside questions of director commitment and development, highlighting that these are connected issues. The question arose, to what extent are the terms and language that boards use to consider succession potentially misleading and misaligned with these goals?

The term 'Nomination Committee' is potentially misleading; nomination implies a transaction whereas in reality effective succession requires a balance between the need for continuity and the need for change and improvement. The implication is that to be truly effective, succession requires that boards think about changing a person, the skills or roles before a change is required. A continuous, forward-thinking process is more effective than a responsive one. Succession planning done well, is most effective when it is a cyclical process, in which boards are engaged in a continuous process of succession.

A 'talent mindset' is required for this to be effective. The phrase 'talent mindset', coined by McKinsey & Co (1997) is more typically associated

with ensuring proactive development and management of young stars. Whilst youth might not be naturally associated with succession planning for boards, the philosophy that every board member is responsible for developing, renewing and proactively sourcing people based on capability, motivation and the strategic needs of the business holds true. Likewise, the view that having the right people, with the right knowledge and behaviour on the board can be as much a value driver for the board as other types of talent are in other layers of the organisation. Of course, the board cannot look solely for talent inside an organisation but must seek the right balance between those who know the organisation inside out and those who can bring fresh perspectives and independent challenges. Included within an effective succession process therefore will be a view of developable skills, not just possible replacement people.

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When might succession planning be inadvertently triggered?

It was discussed that a strategic change of direction necessitates a review of skills on the board, although accessing the real thoughts that people hold at this time can be difficult. Reviewing whether the board needs to change because of a shift in strategy is difficult for board directors to face – in a sense turkeys voting for Christmas. It is likely that every board member will hold a view of what skills are absent from and needed by the board, but accessing those views can be difficult. People are naturally reticent to propose that their own skills or those of their colleagues might not be needed. External facilitation can be a useful tool to surface the views that directors hold, but cannot easily be expressed in open forum. It is not so much that directors don't want to express their views, but that finding the space to articulate them free of concerns can be difficult. One-to-one discussion with a skilled facilitator enables individuals to surface and process thinking without the pressure of having to formulate a complete solution.

As well as external triggers such as a change in strategy, the more difficult to deal with are internal triggers. In the situation where the dynamic of a board appears not to be working sufficiently well, a discussion of succession might be triggered. Locating inefficiencies in the board in terms of insufficient skills or lack of knowledge in one or

more individuals is tangible and straightforward. Earlier address of what is not right with current board dynamics might be more effective than simply replacing people as a result of a crisis. Looking for new people often feels like an easier solution but looking at what is not right can often be a more sustainable solution. Locating problems in individuals is often seen as easier to deal with even when it is obvious that the problems might not lie in the individual but with the dynamic of the group. Changing one individual may shift the focus in the short term toward new relationships and give a sense of invigoration but may not necessarily solve the underlying issue.

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In what way might an orderly process become an overly cosy one?

The chairman's role in maintaining an orderly process was stressed. There are intensely personal relationships behind the decision for chairmen, CEOs or other board directors to join or leave a board. A well-managed succession process will leave directors feeling valued and the organisation feeling confident and well led. Alternatively it has the potential to be the reverse. The role of the chairman is crucial in consulting with and keeping shareholders, executive and non-executive directors informed and involved. The better this is managed, the more likely the process will be perceived as an orderly one. Too orderly, however, might equal a cosy process and signify a conformist culture; a problem which has plagued boards over time and one to which 'outside elbows' is often required to wake up and disrupt the tendency to stick together.

Self-selection breeds a tendency toward group-think and closes the group to influential factors outside of themselves. In the succession process there may be hostility toward the concept of new skills at the risk of compromising renewal, regeneration and innovation. In this situation an apparently smooth process might not lead to a good outcome. Succession planning can become about massaging egos or gifting what has been earned rather than what is needed. A good process is not the same as a good outcome.

The topic of cosiness and self-perpetuation is one at the forefront of a history of financial crises. 'Crony Capitalism', was the description applied to the way in which Japan and Korea suffered in the 1980s and 1990s and is a term easily applicable to the most recent issues in the UK and Ireland. Boards chosen for their connections and the ability

to smooth their way through business might be perceived to be an asset. However, we only need consider cases like the Guinness share-trading fraud in which executives with brilliant strategies and ideas ended up in prison whilst the 'cosy board', who schmoozed but failed to act, went unpunished.

The UK's Corporate Governance Code and the FSA have proposed and are serious about the value of external review as a mechanism to bring attention to the issue of self-perpetuation. Boards may not yet be serious about external review but the FSA and the FRC are, because the problem in self-assessment, is the self. With evidence that an outside lens is vital in breaking up cosiness, board members are wise to look for congeniality where appearance over substance matter.

Choosing the 'right' board members

The question of the complexities of selecting the right person was tabled. Even though NEDs are appointed by the board on the recommendation of the Nominations Committee, and subject to approval of the shareholders at the AGM, is that sufficient to free the NED from the power and influence of the chairman to be his own person? When replacing NEDs, the reasons for asking for a resignation may be about the balance of diversity on the board, or that certain knowledge or skill gaps need addressing. However, there will also be intensely personal and relational reasons behind the decision. This highlights the need for transparency and honesty in the process. The selection and assessment of board directors is a topic that has received much attention, particularly since the recent financial crisis. Those in Significant Influence Functions (not just board members) are subject to review by the FSA, but one has to ask, what are they looking for and are they going about it in the right way? Research indicates that the most valid practices for assessment for competence and truly understanding a person's strengths and weaknesses, involve multiple methods, multiple raters and multiple measures of a person over time. There are substantial differences in sophistication of how corporate businesses and partnerships measure individual capability and how effectively they do or don't relate those measures to development or performance.

This is an extract from a meeting of the Bvalco 'Food and Thought Forum'. To read the whole article as well as others in the series please go to <http://www.bvalco.com/white-papers.htm>.

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