

AN OFFERING FROM BDO'S CORPORATE GOVERNANCE PRACTICE

BDO BOARD REFLECTIONS



PERSPECTIVES ON EXECUTIVE SUCCESSION PLANNING

Succession planning from the perspective of the board of directors is the “art” of identifying and developing candidates, either internally or externally, with the potential to fill key business leadership positions within an organization. There are scores of papers, presentations, checklists and even entire consulting practices predicated on assisting companies and boards with developing succession plans for their businesses. Succession planning has become a key action step for companies of any size, any industry, public or private. When done properly, it can help in ensuring that an organization can keep up with changing times, be more prepared for the unexpected and provide leadership a stronger overall perspective of talent requirements of an organization and the competencies to promote success.

BDO USA CORPORATE GOVERNANCE PRACTICE

BDO USA's Corporate Governance Practice was developed to provide guidance to corporate boards. The firm works with a wide variety of clients, ranging from entrepreneurial businesses to multinational Fortune 500 corporations, on a myriad of accounting, tax, risk management and forensic investigation issues.

CONTACT

TOM ZIEMBA
312 233-1888
tziemba@bdo.com

BDO'S TAKE ON SUCCESSION PLANNING

Most all in the business of advising on succession planning point to a handful of critical items to get right in formulating a good succession strategy. According to Tom Ziemba, PhD, a senior director in BDO's Strategic Services and Executive Compensation practice, any development of a succession plan — whether from a manager level up to a board member, must include the following key processes:

1. Define the role of the project sponsors (e.g., the board) in preparing the succession plan;
2. Develop leadership profiles that describe the current and future leadership competency requirements;
3. Assess the potential and readiness of internal candidates to assume the critical role(s);
4. Prepare individual leadership development plans and a team development strategy;
5. Develop a succession plan that will define development requirements and timing of movement to new or expanded roles; and
6. Utilize the leadership profile and assessment framework to assess external candidates, if needed.

In conjunction with the above, the following features must be embedded to execute an effective succession strategy:

- **Assessment Based** — The succession and development plan is based on a critical review of current capabilities in the context of current and future role requirements.
- **Integrated Approach** — Topics addressed in the succession plan encompass future business requirements, potential market expansion, operational issues, as well as development opportunities.
- **Positive Orientation** — The assessment and development process is viewed as one of skill development and not as remedial. As such, it builds on the strengths of the individual.
- **Focused Talent Planning** — Immediate opportunities to build leadership skills are addressed in the context of a long-range plan.
- **Collaborative** — The overall approach is prepared in a collaborative manner with the project sponsors and is customized to the needs of all stakeholders.
- **Strategic Alignment** — The resulting succession plan and development objectives are grounded in the future direction of the company. As important, the leadership plan is aligned with the governance, strategic, and operational needs of the company.

The resulting succession framework proceeds through the phases of defining business challenges to the organization, development of the executive success profile aligned with these challenges, assessment of potential candidates, honing the succession strategy and development plans for individual candidates and actually administering the program. The "honing" aspect becomes a key part of the process as it allows for continual tweaks and adjustments for changes within the organization as well as those exerted externally on the organization.

The board, specifically an ad hoc component of the board in the form of a nominating committee or an established compensation committee, ordinarily serves as the "sponsor" for succession planning for the top executive roles. The sponsor works directly with the organization's human resource function and may enlist advisors to assist with the process. Such plans may best be formulated on a prospective basis — that is, may take a three to five year approach to a long-term talent acquisition plan. This long range approach may emphasize keeping a pipeline of talent available to avoid the scrambling of identifying leadership in times of "crisis" — illness or loss of life, sudden resignation, etc.

For smaller companies or privately held organizations that may not have a structure that includes a nominating or compensation committee may need to be "creative" in determining who has the responsibility for succession but the concept of having a succession strategy in place is equally important and can be done. The issues with a family run business as compared to an entity not run by related parties may be somewhat different but the underlying approach to building a strategy for succession would be similar.

Any approach would further consider best practices in terms of being able to identify and align leadership with current and future competency requirements; assess strength and depth of available internal talent; and use those currently in the target positions to serve as mentors and help with transition. If possible, the board and CEO may consider benchmarking external talent on an ongoing basis. Triggers are to be identified that signify significant changes in the company's business model which may require updates to the leadership profile. An ideal succession program would reflect the company's governance principles relative to the role of the board and the CEO in building and implementing the succession strategy.

Part of a successful succession plan involves building a "success profile" which includes identifying and comparing various candidates against key competencies specific to the organization across technical, managerial and leadership areas. Methods used to assess the degree to which internal

HOME-GROWN SUCCESSORS VERSUS PROMISING EXTERNAL CANDIDATES

There is a plethora of opinions on the pros and cons of selecting from an internal candidate pool as compared to enlisting external talent. A focused and well planned succession strategy allows a company to channel resources and funding toward internal grooming of professionals who may have a better working knowledge of the business operations, the employee culture and the client needs and wants. These individuals may have more of a “stake” or “loyalty” toward the company than an outsider, who may have a significant learning curve to overcome. However, there are many other factors to weigh that may point toward a need for a “fresh” perspective or an infusing of external experience to align with changing business models and strategies.

Booz Allen's 2012 [Chief Executive Study](#), which examines annual CEO succession trends at the 2,500 largest public companies in the world, cites that of the 15% of CEOs that turned over in 2012, 71% of the time, companies promoted insiders into that role. However, this is down from 80% noted in prior years. Booz further cites that poorly performing companies (in terms of annualized total shareholder returns over the outgoing CEO's tenure) more often hired outsiders than their better performing competitors.

In a recent interview from [“This Week in the Boardroom”](#) (January 23, 2014), Scott Cutler, Executive Vice President of the New York Stock Exchange, indicates, “If you are an organization that is

ready to change and there's a strong need to change, there's less of a need to go outside to do that. If you've got an organization that absolutely is not ready to change [or] they just can't change, and there's a dramatic need for the company to change, well, there's probably a much greater case [for] going outside because either the strategic direction is not there or the organization's not even prepared to make those changes... I think a board, if it's well prepared, [has] shaped a strategy so that [the company] has the ability to be nimble, and [has] also developed talent such that the natural successor knows the business and can take the business going forward, which would favor an internal candidate. It just so happens that there's a lot of instances where the organizations just haven't prepared themselves for the development of that internal hire. I think an internal hire is always your preferred choice if the organization has prepared itself for that element.”

Further opinions as to circumstances that may tip the scales in favor of an external candidate for succession may be found in the [Summer 2012 MIT Sloan Management Review](#) article [“When Is An Outsider CEO a Good Choice?”](#) For example, the article suggests “boards of directors can increase the probability of successful external CEO hiring if they choose such CEOs under the conditions of poor performance and/or high industry growth. Furthermore, external CEOs outperform insider successors when they replace the company's senior management team with new executives. [Their] research also suggests that — contrary to conventional wisdom — company performance usually suffers when new outsider CEOs rush to make strategic changes in the early post-succession period.”

and external candidates possess the competencies in the success profile include personal trait inventories, situational review of decision-making styles, structured interviews, review of accomplishments and self-assessments, where feasible to obtain. Additionally, multi-source assessments from staff, peers and managers may also be considered.

The nomination process weighs the individual candidates and their development potential based on a combination of future potential and demonstrated performance. Within a well-planned succession program that has a suitable timeline, assessed development needs can then be further defined and an approach assembled to ready a candidate to meet future challenges through such activities as special assignments, job rotations, training, mentoring, etc.

Of course, any plan worth its salt would have a review mechanism in place to allow for improvements and recognized developments in the area of succession planning to ensure optimum results are obtained.

CURRENT STATUS AND RESOURCES

The results of a [2014 survey](#) conducted by Proviti and North Carolina State University ERM, which looked at C-suite opinions on their companies' most significant risks, indicates "succession challenges and the ability to attract and retain top talent may constrain efforts to achieve operational targets" is perceived as one of the top five concerns for boards and management. More emphasis, both externally from shareholders and as well as others internally, continues to be placed on objective and independent review of potential executive candidates. Boards are challenged to address such scrutiny in communicating and documenting their contingency planning for the future leadership of the companies they serve.

For more information, tune into BDO's [Executive Succession Strategy archived webinar](#) and access the following executive [succession practices aids and tools](#):

- [Succession Planning — Discussion Guide](#) — Used by those charged with governance to facilitate the development of a success profile for the CEO and/or other top leadership positions. The success profile describes the leadership roles and critical competencies needed to execute the long-term strategy of an organization. Future performance expectations for the organization as well as both anticipated and unanticipated challenges define the long-term strategy.
- [Executive Assessment Results and Development Plan](#) — Used as a sample summary of the assessment results for an internal candidate for the CEO role or other leadership position and identified actions steps in assisting those charged with governance in building a customized plan for the candidate's development.
- [Assessment Instruments](#) — A practice aid providing a brief overview of assessment tools that may be used by those charged with governance in the form of typical instruments used to identify the strengths, competencies, leadership style, decision making approach, and other personality and skill characteristics in their succession planning initiatives. BDO does not endorse a particular instrument. The instruments described in this overview are shown as examples of structured inventories.

ADDITIONAL RESOURCES

The following are links to just a few of many additional resources boards may want to consider in assessing their organization's executive succession plans:

- [BoardMember.com article "Third Quarter 2013 — Who's Next In Line?"](#)
- [Booz Allen's 2012 Chief Executive Study](#)
- [Proviti and North Carolina State University ERM 2014 survey "A Ranking of the Most Important Risks"](#)
- [MIT Sloan Management Review article "When Is an Outsider CEO a Good Choice?"](#)
- [NACD publication "The Role of the Board In CEO Succession" \(for purchase\)](#)
- [NACD BoardVision: CEO Succession Planning](#)
- [NACD webinar archive "How Prepared Is Your Board for a CEO Transition?"](#)
- [Spencer Stuart CEO Succession Resources](#)
- ["This Week in the Boardroom" \(January 23, 2014\)](#)

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