Passing the Torch of Leadership

BY ROBERT P. GANDOSSY AND NIDHI VERMA

In March 2005 Robert Iger, a nine-year Disney veteran, was chosen to replace embattled Disney CEO Michael Eisner despite running against a star-studded cast of outside CEOs including eBay's Meg Whitman, Yahoo's Terry Semel, and the Gap's Paul Pressler. The appointment of an inside candidate demonstrated the board's confidence in Disney's internal talent capability.

Despite a few notable examples of companies that invest in building internal bench strength, many companies don't deal with succession management seriously because they are confident about sourcing external talent when they face a talent crisis. "Twenty years ago," says Jeff Sonnenfeld, associate dean at the Yale School of Organization and Management, "only 7 percent of the firms hired CEOs from the outside. Now it's 50 percent." Although external leadership appointments are gaining ground, experts emphasize the profound benefits of succession from within. Sourcing external candidates is not only expensive, it probably reduces the chances of success for the new leader.

Globally, over the past seven years, home-grown CEOs delivered 1.9 percentage points per year higher shareholder returns than externally appointed CEOs did, according to Booz-Allen Hamilton's annual study of CEO succession at the world's 2,500 largest companies. Further, a company's decision to recruit from outside can have a deleterious effect on its retention strategy. By hiring externally the company sends a dangerous message to its employees that they are seen as incompetent. Internal talent may feel stagnant and uninspired, and may jump ship when their hope of earning a top seat is shattered.

A study carried out by Stanford University researchers James C. Collins and Jerry I. Porras, culminating in their best-seller *Built to Last,* found that companies that maintained a stellar performance and endured through the 20th century had one essential ingredient, a culture of succession management. According to the authors, visionary companies like Procter & Gamble, General Electric, Wal-Mart, 3M, and Sony are clock builders who preserve their core by developing, promoting, and carefully selecting homegrown managerial talent. The research found that visionary companies were six times more likely than other companies to promote insiders to CEO. On the other hand, nearly 34 percent of Fortune 1,000 companies do not have a C-level succession plan, according to Drake Beam Morin, a global human capital management firm.

In the past, when the business environment was less volatile and senior leaders had longer tenures, organizations were not significantly hurt by neglecting succession management. Times have changed. With a looming shortage of top talent caused by the impending demographic time bomb, this lack of preparedness by most organizations can have crippling consequences. A 2005 study by the Corporate Leadership Council found that 72 percent of companies predict they will encounter an increasing number of leadership vacancies over the next three to five years, while 76 percent are "less than confident" in their ability to staff these positions. A top leader's departure from a company can take a heavy toll on employee engagement, business performance, and shareholder value. The crisis is magnified in the absence of any comprehensive succession strategy and program. This article presents a case for introducing or reviving a best-in-class succession management system and examines why—despite the widespread spotlight and renewed attention on succession management in recent times—only a relative handful of organizations are getting it right. The article is based on our experience with numerous clients and on Hewitt Associates' Top Companies for Leaders research, which examines the building blocks that allow financially successful companies to consistently produce a sustainable pipeline of leadership talent. Hewitt's 2005 Top Companies for Leaders study examined 373 public and private U.S. companies.

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Resistance to Succession Processes

Most organizations recognize the benefit of having a carefully designed and well-executed system for passing the leadership mantle. However, they are reluctant to plan for unpleasant scenarios such as an incumbent's exit and often procrastinate and put off the process for the future. For example, even after knowing in April 2005 that Peter Jennings, the incredibly talented anchorman of ABC's *World News Tonight,* was suffering from inoperable lung cancer, the program did not identify a long-term successor, probably to avoid seeming insensitive. Having a succession plan in place would have allowed Jennings not only to have a say in the selection process but to mentor the new incumbent to step into his highly demanding and prestigious role.

Some also fear that naming a successor may cause other talented executives to leave the organization. Neville Isdell's appointment as the CEO of Coca-Cola in June 2004 created a split within the company's upper management, where some reportedly favored the candidacy of Steven Heyer, the 51-year-old former Turner marketing executive who apparently has since left the company. The leadership shuffle at Morgan Stanley in March 2005 would have probably been accepted with less uproar had there been a more focused and planned approach to succession. Amid other controversial and unpopular business decisions, beleaguered CEO Philip Purcell named two new co-presidents to usher in the "new generation of leaders." Purcell's decision seemed to be the final nail in his coffin and triggered a chain of top executive resignations among those who did not approve of his management choices.

Building Best-in-Class Succession Management

Many of these problems arise from succession programs that focus on singular "succession events." Organizations that plan only for one or two senior management departures do little more than pay lip service to succession planning—and invite succession turmoil. Organizations that embrace a formal, ongoing, top-to-bottom succession process that is a fundamental part of the corporate fabric—what we call best-in-class succession management—have developed a key ingredient for long-term success, as Collins and Porras demonstrated.

Where traditional succession planning focuses on compiling a list of possible replacements, succession management is a more holistic and strategic approach to building the internal talent force. It looks to both identify and develop high-potential leaders capable of executing the corporate strategy. *Therefore, best-in class succession management primarily involves two key activities: strategically tracking mission-critical roles that are emerging as "pressure points" and proactively sourcing and developing a strong talent pool of potential candidates to fulfill these pivotal roles.* Best-in-class organizations are those that go beyond the traditional approach and focus on integrated and aligned succession processes aimed at enhancing current and future organizational capacity.

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Succession Cornerstones

The success of a succession management program hinges on having a strategic, systematic, and consistent approach that develops future employee and organizational capability. Succession planning strategies range from simple replacement planning to integrated development planning. The core of developing a steady and reliable pipeline of "A" players rests on five fundamentally important cornerstones—*Alignment, Commitment, Assessment, Development, and Measurement.* Central to the success of the five cornerstones is an unflinching commitment to execution. A carefully designed succession management strategy can fail or wither on the vine because of flawed or no execution. The components of succession management systems are illustrated in Figure 1 on page 41.

Now let's begin to unpack and add some details to succession cornerstones.

Alignment

In an ever-changing business environment, companies need to strive constantly to build a reliable supply of talent, not only to fill executive vacancies but to achieve their future vision. Best-in-class organizations use succession management as a strategic business planning tool to focus on both current and future staffing needs and to develop a pool of highly talented individuals for meeting the organization's long-term strategy. These companies rely on corporate strategies to determine and drive their leadership competencies and talent development needs.

In 2005, IBM refreshed the leadership competencies it had developed in 2003 to reflect the rapidly changing environment, become more future focused, and create "on-demand leadership for an on-demand world." The company interviewed 30 senior leaders who embodied behaviors needed for IBM's future success and developed a new leadership model comprising competencies required by IBM's leaders to build an on-demand culture. For example, "dedication to client success" and "innovation that matters" were identified as two key business values. To support these values IBM defined collaboration and horizontal thinking as competencies to be displayed by its leaders.

At Johnson & Johnson, the Credo, a 60-year-old document, embodies the company's core values and outlines responsibilities toward customers, employees, community, and shareholders. It provides a foundation for understanding leadership development at J&J. Based on the values described in the Credo, J&J created the Global Standards of Leadership, a document designed to provide the organization with guidance for the development of leaders. The Standards of Leadership has the Credo at its core, with business results around it. Each spoke on the wheel—innovation, collaboration, complexity and change, organizational and people development, customer and marketplace focus—represents a management responsibility. J&J uses these standards for evaluating employees. J&J's CEO William Weldon says, "There's forgiveness on the numbers side but not on the Credo values. Business results have to be tied to them."

Real succession management is key to long-term success.

Commitment

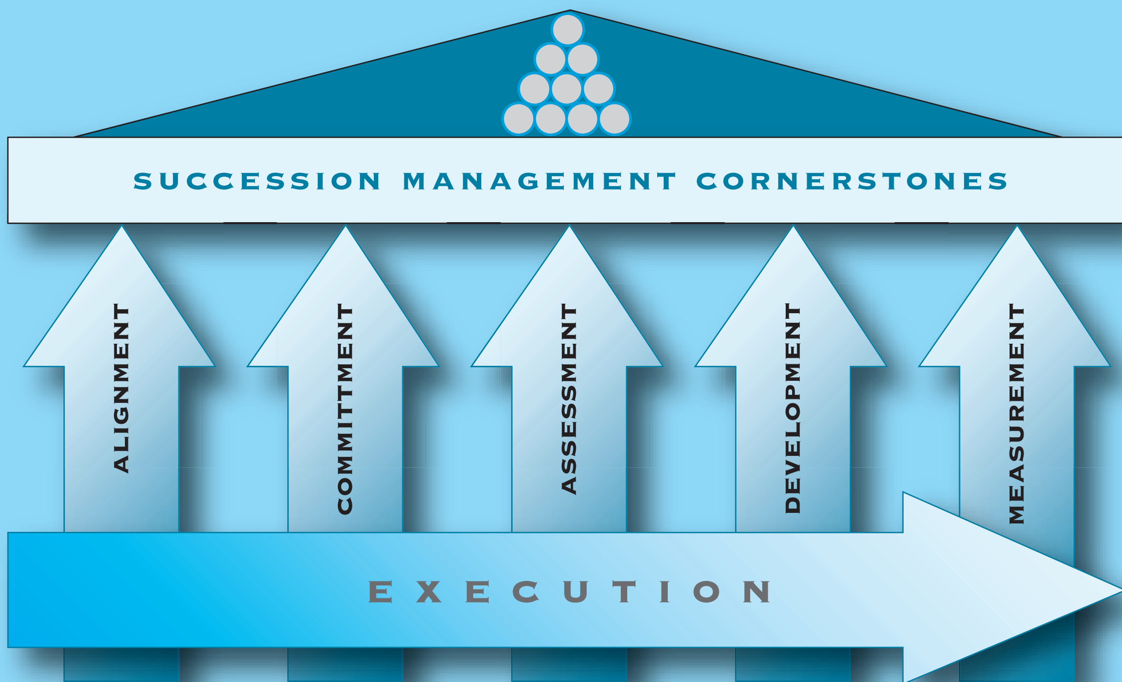
Leaders need to go beyond paying lip service to succession management: real leadership and management buy-in, involvement, and commitment is critical.

Ongoing involvement and commitment takes several forms. First, the senior leadership should play an active role in the succession management process by driving and promoting it as a strategic imperative and leading by example. At General Electric, former CEO Jack Welch—and now Jeff Immelt—have made leadership development a top priority and have demanded that their executives follow suit. As a result, GE promotes nearly 85 percent of its leaders from within. Several of Hewitt's Top Companies reported that their board members visit the high-potentials at their locations and make a concerted effort to know them at a personal level. At one Top Company the CEO maintains a mentoring partnership program wherein he meets with early and mid-career high-potentials throughout the year.

Second, leaders should have a strict discipline to hold managers accountable for identifying and developing talent in their work area by tying it to their reward or promotion. One Top Company links 30 percent of senior leaders' compensation to talent development. Managers are assessed on how effectively they develop talent over a 12-month period and their compensation is adjusted accordingly.

Finally, adequate investment in financial and people resources for succession management will reinforce the point that the senior leadership not only believes in the impor-

FIGURE 1. SUCCESSION MANAGEMENT SYSTEM.



tance of succession management but undertakes necessary steps to embed it in the organization.

Identification

Assessment of mission-critical positions—jobs that are vital for the long-term performance and health of the business—and identifying and stocking pools of talented individuals to fill these positions are critical components of a succession management process. The process of assessing successors usually begins with a well-designed competency model based on the organization's strategic plans. After the core competencies are determined, a battery of methods can be employed to assess employees on these predetermined skills and competencies. Thereafter, candidates can be classified as "ready now" (can be promoted to the next level within 12 months), "ready later" (can be promoted to the next level within a few years), "steady state" (likely to continue developing at the current level), "dark horse" (not keeping up with the requirements of the level), or "newbie" (too early to assess). This grid enables selection and classification of multiple successors or a "chain of successors" for a targeted position and can form the basis for appointing the most suitable successor when an opening occurs.

In the absence of a consistent talent review process, managers rely on subjective assessment of the candidates and base their assessment on personal and often limited impressions of the individual. Moreover, talent identification can be vague and confusing when the criteria or guidelines for assessing talent are not explicitly stated. With no prevalent criteria managers tend to wear perceptual blinders and favor people who seem to be similar to themselves, failing to respect differences in personalities and working styles. Also, managers may rely on brief observations or solitary victories. For example, they may observe someone perform well on a small project and conclude that the employee is a consistent star performer.

Too often the talent review process suffers because of its singular focus on the top echelons. Hewitt's 2005 Top Companies for Leaders research revealed that 65 percent of Top 20 Companies regularly use succession plans for middle management positions while 85 percent regularly use the process for senior management positions. A leading global chemical company focuses heavily on building capabilities of its front-line and middle management employees. The company relies on its "global skill resource managers" to manage one of the seven skill families such as process or project engineers and manufacturing control engineers.

Similarly, focusing on just the star players—employees who can be clearly and easily categorized as high-potentials—and not other solid contributors can also be restrictive. Occasionally, solid contributors—employees with scarce or unique skills, those with critical organizational knowledge, or customer relationship skills—are ignored.

Development

Long-term bench development and advancement is essential for the success of succession management. Best-in-class companies adopt development as a strategic priority and provide a range of targeted development experiences to enhance the capabilities of their future leaders for their "destination jobs." They report offering stretch assignments, internal or external training, nomination to executive programs or MBAs, mentoring, coaching, action learning, and special, enterprise-wide rotational projects. P&G develops internal leaders by moving people within countries, within regions, and around the world. "We want people in roles for three to five years so they live with their own mess," says Moheet Nagrath, P&G's vice president of HR Global Operations. Examples of developmental assignments deployed by Top 20 Companies include nominations to Six Sigma projects and appointments to boards of nonprofit organizations to accelerate high-potential development and provide opportunities to demonstrate skills beyond current job responsibilities. (For a discussion of how nonprofit board service accelerates leadership development, see "Developing Visionary Leaders" in this issue—*ed.*)

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Home Depot is committed to building its internal talent bench. At every step of an employee's career, structured assessment and development programs ensure that the best talent is recognized and developed. Many new hires enter a series of rotational leadership programs—including store leadership, merchandising, business leadership, and internal audit roles. Individuals are invited to participate in the development programs after a rigorous process involving interviews, behavioral assessments, role-plays, and other exercises. There are no promotions at Home Depot without an objective assessment.

The most senior-level employees—the top 100 or so high-potentials—have intensive leadership development programs throughout the year. The Executive Leadership Program, for example, is designed for a group of 30 at Home Depot offices. During the year, members enroll in a three-week program focused on leadership, management issues, and enterprise-wide business challenges. Well-known faculty from across the globe are invited to help facilitate. According to Jennifer Williams, a senior director of HR, these various programs are focused on broad leadership development and are designed to encourage cross-function, cross-business interaction among the company's most promising leaders.

Intel places a premium on grooming internal talent. It practices a method called "two in a box" that allows executives to overlap job duties, learning from and supporting each other in building skills they each lack. They learn new skills while also covering areas in which they lack experience.

Many organizations jeopardize the success of their development programs by adopting a one-size-fits-all training approach. In addition, they do not assign accountability for managing and monitoring the delivery of the programs. Others limit their success by endorsing a polarized approach where they either keep the entire process within HR's bastions without involving business managers or give its full control to line managers with little or no involvement of HR. Both scenarios can spell doom. When managers are not involved in planning and sanctioning development projects for their employees, they are reluctant to champion these programs and encourage their employees to allocate time to undertake them. In the same vein, managers do not have the time or inclination to get embroiled in the tactical and administrative details of conducting developmental activities and prefer HR to guide the process, manage the infrastructure, and monitor employee follow-up in developmental activities.

Measurement

Organizations that do not invest time or resources in measuring the victories and learning from the failures of a succession management program are awaiting disaster. Measurement is twofold: assessing the effectiveness of the overall program and tracking the success of an individual placement.

Since measurement of a succession initiative can be nebulous and nonquantifiable, many companies do not even bother to establish metrics. Such companies face a higher risk of making these processes outmoded and out of touch with real business and individual succession needs, causing them to become unpopular with business managers and employees. Other organizations looking to define metrics for evaluating a succession program blunder when they force-fit an off-the-shelf measurement scorecard without calibrating and customizing it to match the needs and expectations of their company's employees and leaders. Each company should determine evaluation criteria and benchmarks based on the distinct characteristics of its own succession management program.

Model succession management programs use a variety of measures to ensure that desired outcomes are achieved, and they set targets to ensure continuous improvement. These include

- Extent to which leadership job openings can be filled from internal pools
- Average number of qualified candidates per leadership position
- Ethnic and gender diversity in promotions
- Number of positions with two or more "ready now" candidates
- Percentage of high-potentials who complete development plans
- Attrition rate from the succession pool

Further, tracking and measuring the progress and development of individuals targeted for succession is equally important. It is often said that high performance is not just about reaching the pinnacle but staying there. When companies fail to review and measure their high-potentials at regular intervals they do not realize that designated top talents may be underachieving in their new role and may have fallen out of the high-potential status. An individual's performance could be falling either because of failing to achieve expectations in the new role or because of wrong assessment by the employee's manager. One Top 20 Company formally measures the success of succession planning decisions three years after a placement.

It's All About Execution

Failure in execution may be due to the lack of an organization's willingness to execute, its ability to execute, or both. Typically, problems in execution derive from a combination of process issues and people issues.

- Process-based problems include use of a vague and ad-hoc succession management strategy that is not aligned to business strategy; complex, bureaucratic, and difficult-to-understand succession management tools and templates; unclear roles and responsibilities of different constituents (HR, leadership, business managers, and employees); frequent changes to the original process, and similar faults.

- People issues that compound the many challenges of effective execution include resistance from managers and employees, reluctance of managers and employees to commit resources and time, and managers' personal insecurities and prejudices in selecting top talent.

Companies that have effective and enduring succession management programs pay attention to and iron out both process- and people-related execution problems. Hewitt's 2005 Top Companies for Leaders study reveals that the Top 20 Companies get more from their leadership practices by executing them effectively. For example, while 100 percent of the Top Companies and 73 percent of other companies have leadership competencies, the Top 20 Companies are significantly better at integrating these into leadership processes. All the Top 20 Companies integrate these competencies into the succession planning process, while only 78 percent of other companies do so.

Investment in the Future

A best-in-class succession management program is a well-founded answer to an impending business crisis. No business can safeguard itself against key talent departures. At some point a company's critical chairs get empty because of an incumbent's retirement, resignation, poor performance, or untimely death—pushing the organization to search for a replacement. This search can pose significant operational and financial risk if the business has not invested in building its future leadership pipeline internally.

Granted, there is a clear acknowledgment of long-term benefits from robust succession management systems, but organizations are often slow to invest in and commit to best-in-class processes. Lack of a disciplined approach toward succession management or tolerance of substandard execution can seriously injure an organization's efforts at leadership continuity, talent development, and retention of key individuals. The cornerstones described in this article are simple but often overlooked. By working intensely on planning, executing, and winning on the five succession management cornerstones, companies can develop a steady pipeline of competent successors for their targeted, mission-critical positions. ■