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Facing the Void

By Peter Davy

Power vacuums at the top can be hugely damaging. Companies need to put more thought into succession planning

When Herb Kelleher, the co-founder and former chief executive of U.S. airline Southwest Airlines used to be asked about plans for his successor, he would claim there were none. "I'm immortal," he said.

As it turns out, he was joking – about the plan, anyway. Plenty of companies, though, do seem to be relying on their executives' durability. A survey by headhunters Egon Zehnder International earlier this summer questioned 836 top managers around the world. Just a third had a professional succession planning process in place for the leadership team. France, in which just 26% of companies had a succession plan, and Germany, with 29%, were among the least well-prepared. The UK, with 32%, was little better.

That doesn't mean companies haven't considered it at all, but Andrew Munro, director at UK consultancy AM Azure and author of *Practical Succession Management*, says many don't go far enough. "They may have in mind a potential stand-in should the chief executive fall under a bus," he says. "But the percentage that have a professional process that is well thought through and well implemented is pretty low, I suspect." That's a worry, he says, because it's a key business risk.

Of course, not many chief executives do actually fall under buses. True, Joe Sinyor, then chief executive of newspapers at Trinity Mirror, was hit by one in 2002, but only after he had missed out on the group's very top job. Besides, he survived, and fatalities overall are rare. When U.S. magazine *CFO* looked at its Midcap 1500 index of public companies with revenues between $100 million and $1 billion, it found no more than two chief executives or chief financial officers that had died in the job in the past five years.

Unexpected departures, on the other hand, are anything but unusual. This summer alone banknote printer De La Rue in the UK lost its chief following problems at its paper mill, Austrian company RHI AG, the world's biggest maker of fireproofing ceramics, saw Thomas Fahnemann quit for personal reasons. Most conspicuously, Hewlett-Packard's Mark Hurd stepped down after an investigation into allegations of sexual harassment found he had falsified expense claims.

"There's a story every week," says Mr. Munro.

Management consultancy Booz & Company has tracked chief executive succession in the world's 2,500 largest companies for the last ten years. Over that time the average tenure of a chief executive has fallen by almost a quarter, from 8.1 to 6.3 years.

As Wolfgang Doerfler, managing director of talent management firm DDI Germany, says, it's an old joke: "The chief executive is the world's best paid temporary position."

Time is Money

The impact on businesses, however, isn't funny.

Sometimes, it's an upfront cost. Look at the £15 million package offered by Marks & Spencer for its chief executive Marc Bolland, for example. Much of that cost was down to poor succession planning at the firm, argues Robert Talbut, chief investment officer at Royal London Asset Management. Likewise with Adam Crozier's move to UK broadcaster ITV.

"There is a long list of examples where the process to find a successor to the chief executive is quite painful, quite protracted, and in many cases seems to involve a very expensive external search," says Mr. Talbut.

The more profound impact is perhaps harder to measure, however. Josette de Goede, head of executive education and development at Rotterdam School of Management, says the most serious consequence of poor succession planning is the time a company loses. It can take a year to find the right person and get them settled in the job. "The whole company slows, and that gives your competitors an advantage," says Ms. de Goede. "It can end up being very expensive."

Indeed, that's precisely why healthcare group Bupa's chief executive Ray King prefers short changeover periods. "I'm a firm believer in trying to avoid a loss of momentum," he says. "Organizations look to the top for direction and it's just common sense that the shorter the period when there is any uncertainty about that the better."

Perhaps the best test is the shareholders' verdict, and here the evidence looks compelling. A study in 2005 of the share prices of FTSE 350 companies experiencing at least one change in chief executive over three years found that those with clear succession plans performed more than 7% better on the markets a week after the change than those that delayed appointing a replacement. And there was a longer term effect too: Over the whole period of the study, the difference was 2.1%.

Today, the markets seem equally unimpressed by uncertainty. In the week following news of Mr. Hurd's departure from HP, and with no permanent replacement in sight, the company saw its shares drop more than 10% – wiping about $11 billion off its value.

Not Business As Usual

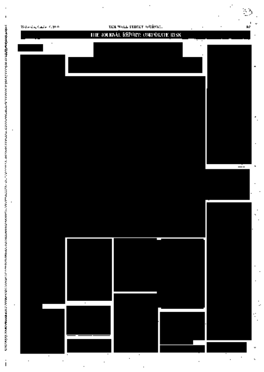
Given this, it is perhaps not surprising regulators increasingly recognize succession as a significant risk. In October, for instance, the U.S. Securities and Exchange Commission, revising its position, published guidance backing shareholders who want greater transparency over companies' succession planning processes. It said: "We now recognize that chief executive succession planning raises a significant policy issue regarding the governance of the corporation that transcends the day-to-day business matter of managing the workforce."

Growing Concern

However, it's not just regulators that are worried about succession risk. So are companies. Researchers at The Conference Board recently surveyed 136 companies in Europe and North America, asking risk management and human resources professionals to rank 21 human capital risks by importance. Succession planning and the leadership pipeline was placed second. Only critical skills shortages in the company's workforce were considered a greater threat.

As the head of the global human capital research program David Learmond says, it's untrue to claim all companies are blasé. "Many take this very seriously."

Certainly there are many exam-



ples of good practice. Tesco's announcement in June that long standing chief executive Sir Terry Leahy would make way for insider Philip Clarke, is held up by many as an exemplar of smooth transitioning. Similarly praised is the recent reshuffling of several top executives at JPMorgan Chase by chief executive Jamie Dimon. The move is supposed to enable them to acquire the skills and experience that will prepare them to potentially take the top job in the future.

"Chief executive and management succession often seems more like a psychological drama or a Shakespearean tragedy than the reasoned and mature process it should," Mr. Dimon wrote in a letter to shareholders. "It is in our best interest to avoid such drama."

Yet many firms still get it wrong. Some of that may be down to negligence. It may also be because, as Mr. Learmond says, enterprise risk management isn't often joined up with strategic workforce planning.

However, it is also probably because succession planning is just not that easy. Even companies with well established programs can come undone.

Look, for example, at the world's largest business software business, Germany's SAP AG. It is renowned for its talent management and planning processes. Nevertheless, in February, chief executive Leo Apotheker stood down less than a year after his appointment in the face of disappointing performance.

As PricewaterhouseCoopers' global head of HR services Michael Rendell says, even the right processes can only give you so much protection: "When you're dealing with human beings things will never run as perfectly as expected."

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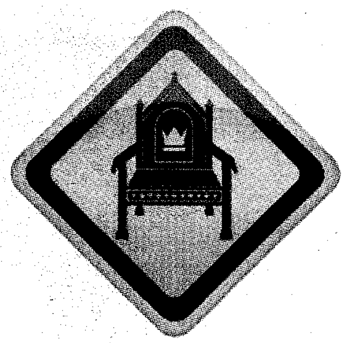
Headless Corps

Do you have a succession plan in place?

Cost	Yes (%)	No (%)
Australia	41	59
Denmark	40	60
Germany	29	71
France	26	74
Great Britain	32	68
Italy	33	67
India	16	84
Sweden	45	55
Switzerland	45	55
USA	32	68
Other	32	68

Source: Egon Zehnder International



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The proportion of companies that have a succession planning process

Martin O'Neill www.cutitout.co.uk