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Centre for Board Effectiveness

Clarkson Centre SME Toolkit #3: Executive Succession Planning

By Matt Fullbrook

In 2006, the Clarkson Centre for Board Effectiveness (CCBE) began a multi-year study of corporate governance in Canadian Small- and Medium-Sized Enterprises (SMEs). This initiative included nearly 100 interviews with SME board members and extensive data collection from public filings of publicly-traded Canadian SMEs. The outputs from our efforts include four years of comprehensive governance ratings for Canadian public SMEs, contributions to the development of the structure and content of the SME Board Effectiveness Program offered by the Rotman School of Management, and a series of practical toolkits for SME boards, of which *Executive Succession Planning* is the third.

From our interviews, the most common recommendation long-standing SME board members and executives have for their peers is to *start behaving like a large company as soon as possible*. In other words, SME boards benefit from implementing formal processes and structures early in their life cycles. Throughout our SME Toolkit Series, we will provide guidance to SME boards on topics that are important to directors, managers and investors, and also recommend resources that we believe will help boards design, implement and execute formal processes in key governance areas. We also offer descriptions of valuable governance structures that are common among larger companies, and explain why and how SME boards might consider applying them in their own organizations.

Executive Succession Planning examines the challenge of ensuring ongoing and seamless leadership even in times of unexpected change, as well as the planning for top management turnover in the regular course of events. CCBE has identified a significant gap between large and small Canadian firms in the development of formal succession planning processes. Below, we inspect this gap and offer guidance to SMEs to help overcome common challenges.

CCBE recognizes the generous support of the Ontario Ministry of Training, Colleges and Universities throughout this research initiative, as well as the Canadian Foundation for Governance Research and Knightsbridge Human Capital Solutions for their partnership in CCBE's 2011 research initiatives.



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CEO Succession at Canadian SMEs

In 2009, CCBE, PricewaterhouseCoopers and the Institute of Corporate Directors asked Canadian board members if they were confident in the effectiveness of their succession planning for the CEO position. On average, public and private SMEs were slightly happier with their succession planning processes (67% indicated high confidence) than their large counterparts (64%).¹ In 2011, we dug a bit deeper, and found a much different situation: Only 54% of Canadian SMEs have succession plans in place for the CEO with suitable candidates identified, compared to 75% of large firms (driven by 82% of large publicly-traded firms).²

Perhaps more importantly, SME directors are not confident in the potential outcomes of their current succession planning efforts. Only 57% of SME boards feel that they will remain effectively staffed at the CEO level under unexpected circumstances, including only 47% of public SMEs.

Considering that nearly all SME directors (97%) believe the board is solely responsible for handling unexpected CEO succession, and more than three-quarters (78%) believe they are solely responsible for CEO succession under normal circumstances, boards' lack of confidence in the outcomes of their succession efforts suggests that SME boards are facing difficult roadblocks.

Roadblocks to Effective Succession Planning

A recent survey of Canadian directors by the Canadian Foundation for Governance Research (CFGFR) and Institute for Corporate Directors (ICD) suggested that the most common barrier to effective succession planning for Canadian boards is a pervasive feeling that it is not a pressing concern.³ This, combined with an ongoing struggle to devote sufficient time to a multitude of board responsibilities, may help to explain the gap between what boards feel they *ought* to be doing and what they are, in fact, accomplishing. But is ambivalence the only obstacle?

Several of our SME interview participants in recent years have encountered resistance from incumbent CEOs when broaching the subject of succession planning. We examined this further in our recent director surveys, which cover a much broader sample of Canadian directors. Although 54% of SME directors face reluctance from top managers regarding talent oversight *in general*, 70% say that their CEO is openly supportive of succession planning efforts in particular.⁴ In a separate survey, only 11% of SME boards felt that CEO reluctance was the most important barrier to effective succession planning.⁵ In other words, boards are taking

¹ CCBE, 2009. *Clarkson Centre-PricewaterhouseCoopers 2009 Directors Survey in collaboration with the Institute of Corporate Directors*, Toronto.

² CCBE, Knightsbridge Human Capital Solutions and the Institute of Corporate Directors, 2011, *Beyond the CEO: The Role of the Board in Ensuring Organizations Have the Talent to Thrive*, Toronto: Knightsbridge.

³ Canadian Foundation for Governance Research 2011 Director Survey, research undertaken by CCBE

⁴ CCBE, Knightsbridge Human Capital Solutions and the Institute of Corporate Directors, 2011, *Beyond the CEO: The Role of the Board in Ensuring Organizations Have the Talent to Thrive*, Toronto: Knightsbridge.

⁵ Canadian Foundation for Governance Research 2011 Director Survey, research undertaken by CCBE

ownership of the challenges they face, and believe that managers are, for the most part, willing participants if and when the board is prepared to initiate a formal, ongoing succession plan. Directors believe effective succession planning starts at the board level.

First Steps to Effective Succession Planning

As with many governance challenges, SME boards feel unable to find helpful and affordable resources to facilitate the succession planning process (only 50% of SME directors believe they have access to valuable outside resources on the subject).⁶ Below (page 4), we have prepared a list of written resources that we feel are of practical value to SMEs in achieving ongoing, top management staffing. However, the potential value of these resources depends largely on the formulation and implementation of ongoing formal processes. Since the most common barrier to effective CEO succession appears to be a general lack of urgency, an important first step is for boards to incorporate talent management discussions into their ongoing annual routine, thus ensuring that it does not get swept aside as new priorities arise.

In spring 2011, CCBE undertook a series of one-on-one interviews with Canadian board members on the topic of talent oversight. While every participant felt that succession planning, organizational culture, and development and training are of high importance, only one out of 14 participants was able to describe a process that had been implemented by their board(s) to ensure ongoing top-talent effectiveness. While the effectiveness of formal processes relies on full participation by the board *and* management, it is important for the board to define their needs and expectations as specifically as possible.

Three key characteristics of effective, ongoing board processes are:

1. **Rigour:** The overall goal of the succession process (e.g. developing and maintaining a list of realistic successors) should be articulated clearly and in sufficient detail to be understood and executed effectively. Each step of the process, as well as the desired outcomes of the steps, should be clearly defined and placed into an annual, cyclical schedule. These definitions should include executable processes for achieving seamless leadership, and may take into consideration broader organizational concerns such as development/training, cultural consistency, and strategic compatibility.
2. **Repeatability:** Although special or unexpected circumstances may require your board to improvise, the creation of a robust and repeatable succession planning process can help limit the need for scrambling in the wake of a sudden vacancy. In this sense, repeatability means that the process is sufficiently detailed, yet flexible, firstly to facilitate the board in its succession efforts without constantly returning to the drawing board, and secondly to be relevant today and indefinitely.
3. **Regularity:** Many formal board processes are incorporated into a board's ongoing annual, cyclical schedule. Since the risk of unexpected CEO turnover is ever-present, and the process of planning for succession in the regular course of events is complex,

⁶ *ibid*

there is tremendous value in ensuring ongoing, formal discussion at the board level. For example, the board will rely on updates from management regarding the identification and development of internal candidates. As part of their succession process, the board may schedule bi-annual management updates on the development of their short-list candidates and/or annual presentations or interviews with those candidates to ensure up-to-date familiarity with strengths/weaknesses and succession feasibility.

Bridging the Information Gap

A board's succession planning efforts can only be successful if the board is equipped with sufficient and appropriate information regarding internal and external talent. CCBE and Knightsbridge found that only 43% of Canadian SMEs are provided with succession plans for top organizational talent below the executive level. Among those for whom this information was available, however, most (82%) took the time to *review* the plans with management to ensure that development was on track. This suggests that boards, once equipped with sufficient information, are enthusiastic about putting it to good use. When an information gap exists, however, boards are missing a vital piece of the succession planning puzzle. Given that management tends to participate willingly in the succession process, SME boards have an opportunity to be more proactive in leveraging executives' knowledge and resources to supplement the board's own efforts.

Suggested Reading

As part of a recent study by the CFGR, CCBE compiled the following bibliography of practical succession planning resources in early 2011:

- Axelrod, Nancy R. *Chief Executive Succession Planning: Essential Guidance for Boards and CEOs, Second Edition*. 2nd ed. Board Source, 2010. Print.
- *The Director's Guide to CEO Succession*. NACD Directorship, 2010.
- Minton-Eversole, Theresa. "Most Companies Unprepared For Succession at the Top." *HRMagazine* 55.10 (2010): 22. Print.
- Conlon, Robert, and Richard V Smith. "The Role of the Board and the CEO In Ensuring Business Continuity." *Financial Executive* 26.9 (2010): 52-55. Print.
- Citrin, James M, and Dayton Ogden. "Succeeding at Succession." *Harvard Business Review* 88.11 (2010): 29-31. Print.
- Dr. Peter Stephenson ICD. D, Ph.D, and Ph. D Dr. Guy Beaudin MBA. *20 Questions Directors Should Ask About CEO Succession*. Canadian Institute of Chartered Accountants, 2008.
- Griesedieck, Joe, and Bob Sutton. *Completing the CEO Succession Planning Picture*. Korn/Ferry, 2007. Print.

- Charan, Ram. "Ending the CEO Succession Crisis. (cover Story)." *Harvard Business Review* 83.2 (2005): 72-81. Print.
- Behn, Bruce K, Richard A Riley, and Ya-wen Yang. "The Value of an Heir Apparent in Succession Planning." *Corporate Governance: An International Review* 13.2 (2005): 168-177.
- Freeman, Kenneth W. "The CEO's Real Legacy." *Harvard Business Review* 82.11 (2004): 51-58. Print.

A more extensive bibliography on succession planning is available through the ICD's Governance Resource Centre

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