CEO succession planning in family business

CEO succession planning is the most critical activity that the board of a family-owned business will ever undertake. Few decisions are more critical to the long-term success of the business and the security and welfare of those who depend on it. Some family businesses have exemplary CEO succession processes in place; others are less sophisticated. The purpose of this paper is to describe the most common approaches to succession planning and offer some best practice recommendations.

In conjunction with FBN (the Family Business Network) in Belgium, Spencer Stuart conducted extensive research to identify some of the best practices (and common pitfalls) in CEO succession planning across Europe. We interviewed 25 chairmen and CEOs of major family-owned businesses ranging from third to seventh generation ownership.

Our research reveals a surprising variety of attitudes and approaches among FBN members as they face the challenge of choosing their next leader. Some of these differences are accounted for by the size and complexity of the family, the involvement of the family council, what the family charter may or may not say about succession planning, and the extent of leadership talent among family members and within the business as a whole. Other differences relate to the board's capacity and readiness to handle a process which requires significant time, effort, knowledge and experience to get right.

CEO succession — the board's most critical task

Appointing a new CEO is rarely an easy task. It can be traumatic as well as challenging for all concerned. A robust succession process featuring thoughtful and continual preparation is vital. It is the chairman's responsibility to achieve consensus among family members and this will inevitably involve some degree of compromise. Decisions must be shared and everything should be done to avoid board or family council members from blaming each other in the event of a bad outcome.

Successful CEOs of family businesses are a particular breed and not easy to find; they are highly competent business leaders skilled in navigating all the usual external market pressures, but equally deft in dealing with the expectations of family members, whether they be on the management team, the board, or the family council.

While many of the most successful CEOs are family members, companies have to prepare for the eventuality, or at least the possibility, that the person best suited to be their next CEO will not be a family member. The appointment of a non-family CEO becomes more likely as the business passes into the hands of successive generations. That said, the likelihood of developing family members with the requisite qualities of a CEO may well increase over time.

In considering whether to recruit an external professional to lead the business, much rests on how well the outsider will be able to cope with the dynamics and culture of the family. Indeed, when things go wrong for family business CEOs it is not usually their business competence which is responsible, but rather their failure to manage the expectations and aspirations of the family.

The five golden rules of CEO succession planning

1. There must be close alignment between the family, the board and management with open communication throughout the process.

2. There is more than one successful model for CEO succession. The situation facing each family business is unique, so transferring a solution from another business is not necessarily optimal.

3. CEO succession cannot be viewed in isolation; it must be seen in the context of the succession of the board as a whole and that of its chairman.

4. A transparent governance model should ensure a clear separation of roles between the family council, the board and management.

5. A family charter should set out guidance, if not rules, for CEO succession planning. It should also address the development of members of the next generation who will represent the family's interests in the business.

The link between governance and CEO succession

Governance structures and decision-making mechanisms have a significant bearing on how family businesses approach the question of CEO succession. Our research revealed several factors that tend to be present among boards overseeing the most successful CEO appointments:

- » A transparent governance model with a clear separation of roles between the board, the family council and the CEO.
- » A family charter which sets out guidance, if not rules, for CEO succession planning.
- » Independent directors on the board who can bring an outside perspective. The best independent directors identify with the business, bring an objectivity to the board's deliberations and act as a useful counterweight when the CEO is a family member. Some boards prefer to retain independent outside advisors who can play devil's advocate and raise difficult issues that others may avoid.
- » A chairman who leads the succession planning process and who is rigorous about involving different stakeholders in the selection process at the appropriate time.
- » A nomination or selection committee with a remit to continuously review options and plan for eventualities, rather than tackle succession issues on an ad hoc basis.
- » Rigorous assessment which evaluates, inter alia, relevant experience, past performance, future potential, development needs and cultural fit. This assessment is conducted by third-party assessors using state-of-the-art methodologies.
- » Tenure limits for CEOs in recognition of the need to have leaders whose competence is aligned with the changing nature of the business, to "keep the CEO sharp", and to send a clear signal to upcoming talent that their route to the top is not forever blocked.

CEO succession as a continuous process

One of the characteristics of a smooth succession process is that it begins several years before the anticipated retirement or departure of the CEO. The earlier succession planning starts, the more options that will be available when the time comes. The company's strategy should provide the basis for creating the specification of the next CEO and for identifying potential successors. In an era of disruption and sector convergence, the risk for some family companies is that they will remain in one business alone. The question of leadership succession can trigger a timely strategic debate about whether to 'keep your eggs in one basket' or broaden the business portfolio or, even further, whether to transform completely the company's DNA.

Some companies address the question of CEO succession on an ad hoc basis and only when the need for a successor comes into focus. Several of these companies acknowledged that they had to put a more structured process in place in future to avoid making hasty decisions, having too few options or losing key executives. This is a time when the presence of independent directors on the board can make all the difference, since they can offer much-needed experience and objectivity when it comes to planning and the assessment of candidates.

The majority of boards see CEO succession planning as a continuous process. It appears on the board agenda as a regular item and is closely linked to the issue of management development. “We pay constant attention to CEO succession,” says one chairman. “We do not want to be facing time pressure, but instead we want to master the process at all times.” Another board member noted that the board “formally discusses the succession strategies for the CEO and executive committee members twice a year. It is a continuous process: the moment a new CEO is appointed, we start thinking about their successor.” This point was echoed by another chairman who involves the new CEO in preparing for his successor from the outset: “As soon as the new CEO has taken office, the reflection on the next one starts. This also becomes a task for the newly elected CEO and is one of the elements on which he or she will be evaluated.”

Where to look for the next CEO?

The most fundamental question facing a family business is how wide it is prepared to cast the net in its search for the next CEO. During our conversations with chairmen and CEOs we heard the full spectrum of responses to this question.

The nature of the CEO search will be dictated by whatever strategic decision the business may have taken to combine or separate the ownership and management of the company. Our research found that companies that have survived into the third generation or beyond fall into one of four categories, listed opposite.

What qualities are required of the new CEO?

There was consensus among the chairmen we spoke to that the future CEO should have vision, leadership skills, drive and dynamism, regardless of whether the CEO is a family member, a company insider or an outsider. For a non-family member, a high degree of cultural fit and sensitivity to family issues is essential: the CEO must subscribe to the purpose, objectives and values set out in the family charter or made somehow explicit.

One chairman was more specific about the desired criteria: the future CEO should have senior leadership experience in a mid-sized or large company, bring management skills from a structured environment (best practices), have international experience, and understand the dynamics of a family business.

Competence to lead the business into the future is a *sine qua non*, along with strategic skills and a flexible mindset. The CEO successor needs to possess considerable intellectual fire power, the ability to understand and anticipate market trends, and a strong chemistry with other members of the management team. The CEO needs to be able to earn the respect from the workforce, have an affinity with the board and, most importantly, with the chairman — this relationship will be critical to the success of the entire enterprise.

APPROACHES TO CEO SUCCESSION

The CEO must be a family member	This approach values continuity and the closest possible ties between ownership and management. It is born of a desire to "preserve the family business and character of the company". It puts the onus on the company to ensure that high-potential family members are identified early and given enough time to develop their skills and experience (often through stretch assignments) to ensure that the successor CEO is ready at the right time. This approach can create difficulties, for example not having a suitable family member ready to take over when needed, or having to balance the interests and expectations of different branches of the family. As one advisor put it: "You need to be purely performance-based. The most talented person gets the job, regardless of which family he or she comes from."
The CEO cannot be a family member	In these companies, a deliberate decision has been taken to separate ownership from management. Among other things, this gets around the highly divisive situation of the family member CEO who fails. The new CEO could be a company insider, but could equally be brought in from outside the business. Some companies have gone even further, barring family members from holding any senior executive positions "in order to avoid conflicts inside the family branches and to be sure that the company will attract the most qualified candidates." (There is also a recognition that it can be extremely difficult to fire a member of the management team who is also a family member.) In companies that fall into this category, the charter will often state that the chairman of the board should be a family member, providing reassurance to family shareholders that the agency model is operating in their best long-term interests and that of the business. However, it is becoming more common for neither the board chairman nor the CEO to be a family member.
The CEO must be promoted from within the business, whether or not they are a family member	This is the most common approach to CEO succession among the companies we studied. It prioritises stability, continuity and a deep understanding of the business, its culture and heritage. It assumes that enough talent exists within the business to provide the board with sufficient options when the time comes to appoint the new CEO. As with the first category above, this approach makes the early identification and development of potential successors essential, since the option of looking outside the business is not available.
The CEO can be a family member, a company insider or an external hire	In this scenario, the overriding consideration is the competence of the individual and their readiness and suitability to lead the business. Every option is on the table and the candidate pool is potentially unlimited. In almost every company we spoke to there is a clear preference for grooming an internal candidate wherever possible. However, the board needs to have a process in place for benchmarking internal talent against the external market and assessing the different strengths and weaknesses of family, internal and external candidates. We came across companies in this category who had switched from an outsider to an insider as their CEO and vice versa.

The role of the chairman and the nomination committee

In each of these scenarios, the chairman normally plays a crucial role orchestrating the succession planning process. Some chairmen are more hands-on than others. One has regular interactions with the CEO and head of HR to ensure that the most talented people are kept motivated and challenged. "As chairman, I make myself known in the businesses," he says. "I visit international operations and speak regularly to managers at the N-1 and N-2 level, in order to identify the pipeline of most talented and suited people. I spend time with many key people, getting to know them personally and also their families when possible."

The chairman cannot possibly manage CEO succession alone and so much of the heavy lifting will fall to the nomination committee (or its equivalent) to drive the process, albeit under close guidance from the chairman. There are many factors to consider and as the market changes so must the board's thinking about what kind of CEO the business needs.

When planning CEO succession over the long term, it may not possible to create a precise specification for the CEO role, given uncertainties over the future state of the market. What matters is that the nomination committee constantly re-evaluates the skills and attributes of the next CEO in terms of the changing market environment and the strategic direction that the business is due to take over the next 5–10-years. This might mean looking for someone with deep knowledge of an adjacent industry, for example, or someone familiar with new, untapped geographies.

In addition to determining selection criteria, the nomination committee must get to know high-potential executives throughout the organisation and ensure that they are given the right opportunities to develop into CEO material.

The nomination committee must always consider the broader picture. It may happen that both the chairman and the CEO are due to change at around the same time, in which case careful thought needs to be given to how these two crucial leadership transitions should be synchronised.

Succession planning does not always go to plan, of course. If the CEO departs unexpectedly, the board has to be prepared to ensure management continuity. The board and the CEO should together establish a strategy in advance and define the procedures which will take effect if an emergency occurs. The chairman of the board and the nomination committee should know the potential candidates who are willing to take on management responsibility in an emergency or which board member may be able to step in.

The role of HR

In most businesses we surveyed, the human resources (HR) leader plays an important role partnering with the board and managing learning and development programmes for executives in the business, while keeping an eye on talent outside the business that may be of value in the future.

A number of chairmen felt their businesses lacked a well-structured programme for developing talent inside the organisation. “Today it is more of a ‘gut feeling’,” said one. “Implementing more professional HR systems and policies will probably help in achieving this goal.”

At a time of market uncertainty and growing complexity, family businesses can no longer afford half measures when it comes to conducting succession planning and talent development, which are flip sides of the same coin. The absence of an experienced and high-performing HR function is increasingly seen as a handicap; several chairmen we spoke to signalled a commitment to introduce more structured processes to support talent management and CEO succession planning. HR leaders of family businesses therefore should play a key role in advising the chairman, the CEO and the nomination committee on the following items:

- How to structure the succession plan
- How to define the candidate’s profile
- How to capture the cultural values expressed by the shareholders
- How to prepare the expectations of the shareholders
- How to prepare the board to discuss succession planning
- How to appraise the incumbent CEO
- How to help the board and the next generation develop better capabilities

This is not an exhaustive list, but it gives a sense of the strategic agenda for top HR leaders of family businesses. As the execution of all these activities necessarily requires the intervention of external consultants, HR leaders should also be prepared to advise the board accordingly.

Preparing the next generation of leaders

Family businesses need to address the broader question of next generation succession alongside the specific issue of who will be the next leader for the business. Identifying potential leaders from within the business is just the start of the succession planning process. The most crucial next step is for HR to assess each candidate’s strengths and weaknesses and create a structured career path, providing tailored development opportunities.

Rotating high-potential executives through a series of roles that will expose them to different business units, functional areas and regions is commonplace, particularly for family members with the aspiration and drive to progress.

Some chairmen take the view that only family members who have the potential to reach the top of the organisation should be hired to work in the business. Managing expectations is important for maintaining family cohesion and helps avoid difficult decisions further down the line.

When family members with the requisite talent and potential are identified, they should be given roles within portfolio companies and even at board level if they are ready. "The idea way to prepare them for the CEO role is to slowly let them grow and mature in operational roles and with increased responsibility," says one chairman.

A number of companies put their high potentials through executive education programmes offered by business schools. Some insist that younger family members aspiring to senior executive positions gain experience and perspective outside the organisation, preferably in a multinational and not necessarily in a family business.

Some companies have strict criteria for family members being considered for senior management positions. They go to considerable lengths to ensure that they have to jump through all the same hoops that would be expected of a non-family member. "In the family charter it was decided that family members must have a university degree and have gained relevant experience outside the family business for at least 10 years. In terms of salary, they can only earn the market rate and no more than a non-family member would be paid in the same role."

Whether the family branches are capable of providing the company with its next CEO or chairman, it is extremely important to secure the next generation's interest and attachment to the business. As the family branches expand and spread across different geographies, it is increasingly challenging for the family members to stay connected, to know each other and to share a common value, purpose and business interest. Thus, current family leaders, and the chairman more than anyone else, should make it a specific task to promote opportunities to get together. Family happenings, family clubs and celebrations are used by our interviewees to create, develop and syndicate the family's values.

The CEO and the board

Almost all the chairmen that we surveyed consider that the CEO should be an active member of the board (with the exception of those countries in which the prevailing corporate governance model does not allow it). Not only is a seat on the board a key incentive for aspiring CEOs, but a clear demonstration to the CEO that he or she belongs and is expected to participate fully in decision making at the highest level. It also ensures transparency and a unity between governance and operational execution.

As a board member, the CEO has direct and regular contact with other directors, and as a result is more engaged, aligned and accountable. One chairman was adamant that the CEO must be on the board because he or she will have "a much better sense of what is strategically important, what is sensitive, what is top of mind for the other directors. The head of the family council is also a board member so the CEO can hear first-hand what keeps the family shareholders awake at night."

Not all boards of family businesses have independent directors yet, but we think this situation will soon change. There is now an almost universal recognition that independent directors are an essential feature of a high-functioning board and more than enough that highly reputable, proven business leaders are willing to join the boards of family

ARE WE MAKING THE RIGHT DECISION?

THE POWER OF FORMAL ASSESSMENT

When it comes to choosing the next leader for your organisation the stakes are extremely high. A high-quality assessment of finalist candidates, tailored to the specific family business context, will provide insight and objectivity to the board as well as reassurance when they come to make their decision. Even where the preferred candidate is a family member there is always more to be learned about their capacity to step into the top role.

Nomination committees need to work closely with HR to track candidates closely and continually evaluate their progress. Several chairmen we interviewed stressed the importance of evaluating family members with the same rigour as they would any other contender for the CEO role. This helps prevent a loss of motivation among non-family executives ambitious to fulfil their potential.

Retaining an external consultant to conduct an assessment of potential CEO successors can be extremely powerful, especially when using a scientifically proven methodology that offers a high level of objectivity. At the same time, special attention to the emotional aspects embodied in family business is fundamental; performing CEO-succession activities such as a board review and individual assessments without keeping in mind that many stakeholders are "there to stay", would be a big mistake.

Most traditional assessment approaches weren't designed to predict whether an individual has the ability to stretch beyond his or her current capabilities to grow successfully into a new job and change along with it and the organisation.

So how can family businesses improve their ability to make the most critical senior leadership decisions?

An assessment should provide insight into an individual's capacity to develop new capabilities and respond to changing leadership demands and evolving business conditions and priorities. For example, the potential successor needs to be someone capable of scanning the external environment to see what could affect the business, and driving results over the long-term through people — i.e. the senior team and the broader organization.

An effective assessment employs a range of methodologies to evaluate an executive from multiple angles and perspectives, going deep to illuminate aspects of the person such as their motivation, values and personality in addition to capabilities and knowledge.

Combining executive-tailored, experience- based interviews, interpersonal style questionnaires, live-case-based demonstrations, 360-degree referencing and/or surveys improves the overall accuracy of an assessment and provides the inputs for rich, comprehensive and powerful insight into the person.

companies and that their contributions are highly valued. Importantly, CEOs welcome the presence of independent directors at the boardroom table, finding their contributions both challenging and stimulating. More than one non-family CEO expressed the desire to have a highly qualified board with at least one senior director bringing a proven track record as CEO.

Family businesses are in the unique position to build a well-balanced and highly competent board, with an optimal mix of long-term committed shareholders' representatives (the family), the representative of the management team (the CEO and, more rarely, the CFO or another senior executive) and top-class independent directors who bring complementary capabilities.

Interaction between the family and management

Most businesses we surveyed, and all of the larger, more established ones, maintain an arms-length relationship between the CEO and the family. "This needs to be organized in a strict and controlled way," says one chairman. Shareholders cannot interfere directly in the operational aspects of the business or in the CEO succession planning process.

Tips for effective CEO succession

» Incorporate the principles and procedures for CEO succession into the family charter.

» Start the succession process early, preferably as soon as a new CEO is appointed.

» Make CEO succession planning a constant focus of attention for the board.

» The chairman should lead the process, supported by a fully engaged nomination committee.

» Consider the broader picture: how will the chairman and CEO changes be synchronised? Any long-term plan should take into account succession for both roles.

» Independent directors are essential to carry out an objective, impartial, merit-based CEO succession plan.

» The company's strategy should provide the basis for creating the CEO specification and identifying potential successors.

» Establish early on whether an external appointment is an option.

» Even if the preference is to appoint a company insider, conduct external benchmarking.

» Be as disciplined as you can in planning ahead. Have clear rules of engagement for identifying, assessing and developing the next generation.

» Potential successors should be given stretch assignments, rotated around the business, and encouraged to take advantage of executive education opportunities.

» Consider appointing the preferred internal candidate to the board, thereby providing further training and additional exposure to company matters.

Some companies specify that the CEO should never be a member of the family council (or shareholder committee, as it is sometimes called). Others put formal restrictions on individual family members contacting the CEO and vice versa. Instead, any contact between the board and the family is channelled primarily through the chairman.

There are typically two occasions a year when management and the family meet. One of these is always the equivalent of an annual general meeting at which the results are disclosed. The CEO, often accompanied by the senior management team, provides family members with a detailed update on the state of the business, setting out the key strategic, financial and operational issues.

In addition to these twice yearly meetings designed to keep family members informed about the business, some companies have formed 'clubs' for the younger generation so that they can gain a sense of belonging to the broader family and its enterprise.

This has two particular benefits: first, to inculcate the aims and ethos of the business in all family members (regardless of whether they will participate in the running of the business); second, to provide inspiration for young people with an affinity for the business and give them opportunities to show their potential.

Conclusion

Few tasks are more critical to a family enterprise than securing its leadership succession. Yet many family businesses are giving the matter far too little attention and do not have a coherent plan.

The chairman plays a pivotal role in making sure that the optimal process is followed, obtaining consensus among family members along the way and ensuring that progress is communicated in a timely manner, usually through family council channels.

Conducting a successful CEO succession programme takes time and includes a complex list of activities. The board must be prepared to make the necessary commitment to secure the best possible outcome. This often means ensuring the right governance model is in place and enshrining a more formal approach to CEO succession in the family charter. Aligning the family shareholders with the board is a golden rule for successful CEO succession.

Even if all these things are in place, there is still no guarantee of success in appointing the right person. However, much of the risk can be mitigated by approaching the CEO succession holistically and by employing the most sophisticated assessment tools. Such tools provide a thorough analysis of the functioning of the board, helping define the company's culture and the shareholders' values, while indicating how the capabilities of board members might be developed (especially the less experienced next generation family representatives). At the same time, they identify CEO succession candidates' strengths and weaknesses, as well as their potential to grow and succeed in the job.
CEO succession is far too important to be left to guesswork.

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