SUCCESSION PLANNING — WHAT LIES AHEAD

There is a growing realisation, in India and abroad, that anticipating leadership change and planning an organised internal leadership transition is a critical process in the growth of an organisation, while also providing stability and confidence for stakeholders. However, few organisations put the theory into practice. Businesses are put at risk when boards do not have a carefully planned process for managing succession, and this is often because many leaders, especially those in family-run businesses, find the topic extremely uncomfortable to discuss. How can this risk be avoided?

Succession planning is a critical and topical issue for organisations, whether or not they are being faced with a leadership change. In fact, in today's fast moving environment, this issue may be more important — and more difficult to conduct — than ever before. And while all senior executives agree on the value of identifying successors, it remains to be seen how many actually are in the process of preparing someone to take their place.

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Having a succession process in place is vital to the success of an organisation because the individuals identified in the plan will eventually be responsible for ensuring that their companies tackle future challenges effectively. The process provides continuity and prepares companies and employees for future needs, since it assures a steady flow of internal talent to fill important vacancies. It is also an important risk management tool, since a well thought out process minimizes disruption and dislocation when the leadership baton is actually passed.

Spencer Stuart believes that adopting a clear, comprehensive and objective succession planning process is more than just a mark of good governance — it is critical for the healthy performance and sustainability of any organisation, and for investor confidence in the case of public companies. For succession to be effective, company management, together with the board, need to articulate a clear strategic vision for the future of the business. It is vital that potential successors — whether for CEO or other senior functional roles — are equipped to lead the business as it will look in the future, not as it stands at the present. We partner successfully with many organisations, advising and helping them prepare for a range of scenarios, from long-term controlled succession to emergency succession.

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CEO succession

In the US, CEO transitions in forward-looking organisations are planned and driven by well-thought out processes. In the past, the CEO often orchestrated his or her own succession, with the board playing a relatively perfunctory role — by just approving the outgoing CEO's recommendations. However, as Dayton Ogden, Spencer Stuart, explains, the situation has changed: "The most significant trend observed in the US is that boards have really taken up the responsibility for CEO transitions and regard them as the most important fiduciary responsibility that they have, along with ensuring the financial integrity of a company's accounts." Being such a critical issue, the board also needs the right tools to manage succession effectively, mitigating the risks associated with new leadership appointments.

The succession process can be a completely in-house exercise, or it can involve external consultants. The most important step is to formulate a timeline, starting between two and three years before the anticipated transition. This gives the internal contenders the very best chance of closing any gaps they may have in terms of their own personal development. Furthermore, a CEO transition process cannot start if the board has not reached a consensus on strategy. The nature of the organisation's strategy will determine the selection criteria for its new leader. Dayton Ogden says: "Many boards make the mistake of designing criteria appropriate for managing the company as it is today, as opposed to what it needs to be in the future." The criteria also need to include both experience and personal characteristics, such as communication skills, leadership skills, integrity and the ability to deal with external constituencies.

The next step involves putting the internal contenders under the microscope using rigorous assessment tools that give a clear indication of each individual's strengths, limitations and development needs. Development plans for each individual are then formulated to take care of any identified gaps.

The next vital step is to look at outside talent — CEO-ready executives who meet the criteria identified by the board. This may not necessarily involve the active recruitment of an outsider, but a benchmarking exercise gives the board extensive information about the capabilities of people outside the organisation. Armed with this information, the board can do a gap analysis which may help them decide whether an insider or an outsider is better equipped to meet the ongoing needs of the business.

If an outsider candidate does not produce a significant differential in terms of capability, either strategically or operationally, it is probably best to continue with the internal candidate, unless real transformation is needed that can only be delivered by an outsider. Recent Spencer Stuart research, which looked at the last 300 CEO transitions in the S&P 500 over a period of five years, revealed that in stable, healthy growing companies, insiders outperformed outsiders. The reverse was true in companies that were financially challenged, involved in scandals or had not focused on talent development. It was clear that the latter required transformation and outsiders were seen to be more effective in this context. Deepak Satwalekar, Infosys Technologies, says: "I am a very strong proponent of looking at candidates internally before going outside, because organisational values and culture are very important and one would not want to get an outsider who is completely unfamiliar with that. Unless you can find someone who is significantly superior to any other candidate available in the company, an outsider should not really be considered."

The Indian scenario

Succession planning should not only encompass CEO transitions and the building of in-house talent, but board appointments as well. The process needs to be applied to the whole business ecosystem, so it is important to have frameworks for each of these areas.

Furthermore, the shorter the time available for the succession to happen, the more frantic the activity and confusing the debate gets. In India, unlike in the West, there is a cultural problem — while everyone agrees to the theory of succession planning, when it comes to implementation, social norms kick in. So while there may be a capable contender, he or she may not be the one that is actually appointed.

R Gopalakrishnan, Executive Director Tata Sons, says, "The answer to this problem lies in modifying the ecosystem. What it lacks is powerful, continuous conversations about succession. Succession is not an analytical exercise, but a reflective one. Also, being an intuitive process, conversations help people get their minds around the subject." A classic case of continuous succession planning is Hindustan Unilever, which identifies high performers early on in their careers and tracks their performance through the ranks. In time, the discussion reaches the board and even though there may not be consensus, the different points of view about these individuals contribute immensely to the decisions that need to be made.

SUCCESSION IN GOVERNMENT

Effective succession in the government, because of changing regulations, happens more often by accident rather than by design. Due to the lack of planning, a vacancy is often filled with an available candidate, rather than the right one. Attempts have been made to bring more organisation to the process and selection committees have been formulated, but time constraints make it difficult to arrive at recommendations based purely on qualifications and abilities. This approach is worrying and needs to be addressed. "In the public sector," M Damodaran, Chairman of the Damodaran Group (former chairman, SEBI[1]), explains, "the focus is largely on errors of commission; a lack of decision making is not viewed as much of a problem, wrong decisions are the ones that are highlighted." The challenges are compounded by the composition of the public enterprise selection board, which largely comprises of retired public officers who may or may not have expertise in the relevant fields of business.

What the government and public sector really need to do is bring in outside expertise, to identify positions that will fall vacant well in advance, identify more than one person for the post and develop their skills, invest in mentoring that person, and see whether he or she has the right experience and the temperament to lead the organisation in the current context.

All this sounds like a lot to achieve, but each step forward will help in making the succession process in government and the public sector more transparent and effective.

1 Securities and Exchange Board of India

BOARD SUCCESSION

Indian boards are faced with one major challenge — once a company commits itself to a succession strategy, how does it identify and get the right independent directors on its board? This is especially important today for three reasons. First, high standards of governance are expected from companies that want to build a lasting positive reputation. Second, without the best directors on the board a constructive discussion on CEO succession will not be possible. Third, boards need different perspectives and opinions to be expressed.

Deepak Satwalekar says, "One of the most important questions a board needs to ask itself regarding director selection is the approach it needs to take — is it an ad hoc decision, is it a decision driven by a vacancy, or is it a result of planning?" The answer is critical especially in the event that future governance regulations limit the number of directorships an individual holds and the permissible length of tenure. This is likely to result in a higher turnover of directors on boards, making it important for boards to put more effort into deciding the skills, attributes and qualifications that they would like to see in a prospective director.

The degree of engagement that a director can have with the company should also be taken into account. According to Tino Puri, Spencer Stuart India Advisory Board: "If one has a day job, one can probably do justice to two or three boards, with the limited time that one has. This leaves us with a major problem, because the only people who can do more are people who do not have full-time jobs — retired people, ex-bureaucrats or ex-consultants — which obviously is not an adequate pool of people. We need to urgently broaden this pool."

It is also important for boards to understand that the demographic profile of India has become younger — half the country is now under the age of 25. Growth in new businesses is being driven by the entrepreneurial skills of the younger generation. It is the same on the other side of the spectrum, with youngsters driving consumerism. If a company wants to understand this consumer segment, familiarity with social media and other communication technologies is critical. As Deepak Satwalekar explains: "I think if we are to understand these young consumers and their aspirations, we need to really start casting our nets a little wider than the friends, relatives and icons that we have on boards in corporate India, and include young, accomplished individuals on boards."

Furthermore, if the board is to play a meaningful role in succession planning at the CEO level, then the independent directors need to be very familiar with the internal candidates and engage with the level below the chief executive. The board does not have to concern itself with the technical competence of a candidate, since the fact that he or she has risen to that level is proof enough of it. It is the leadership skills, the ability to get on with people and deal with stakeholders and regulators that the board needs to judge.

Last but not least, independence is a state of mind; it is not something that can be determined by regulation alone. To be truly independent means that the director should be willing to put his or her relationship and position on the board at risk at any time in the interests of the business. According to Tino Puri: "It is something of an oxymoron, because one is not invited to the board unless one is known to the CEO, but while accepting that relationship one has to respect the position and be able to tell the person or the family what is right. If one is not willing to accept it or do it, then the only real option is to leave the board — sooner rather than later."

SUCCESSION IN FAMILY BUSINESSES

A general observation made about the majority of family-owned companies in India is that families need to justify the decision to choose members as successors, especially in listed companies. There is a demand for greater professionalisation of the business and a separation between ownership and management.

At the same time, there are lessons to be learned from the private sector which has made considerable progress in the area of succession planning. The question is, what is driving this progress? According to Cyril Shroff, Managing Partner, Amarchand & Mangaldas & Suresh A Shroff & Co, "the breadth and extent of the nature of wealth has changed in India; there are a lot of inter-generational dynamics being played out. Companies are moving from founders to sibling partnerships and moving from sibling partnerships to cousin consortiums." Two types of families are emerging: the enlightened ones and the not-so-enlightened ones. The former are able to learn from the experience of others; they listen to people with expertise and learn from what happens in the world outside. This makes them stand out — in India and globally.

Succession is also being driven by globalisation and exposure to global influences. A large number of second-generation businessmen, future inheritors and new entrepreneurs have been educated abroad, returning with degrees from prominent universities. This has given them exposure to a number of global economies and they have returned to their roots with a vision for India that spans the next 50 years. For those inheriting businesses, the need to protect the brand of the corporation as well as their own family is important. They are increasingly aware that succession is a critical aspect of business continuity which needs to be thought through in advance and handled carefully.

Family businesses, according to Cyril Shroff, have a 'power structure', which emanates from the type of ownership. Companies are putting in place frameworks that will define the future organisation and ownership of the business and the distribution of responsibility. Different power structures give rise to a variety of complications and many families are spending a lot of time drafting family constitutions, with expert help from the outside. The constitution forces the existing and future leaders to think about succession and other issues relating to generational change.

There cannot be progress on succession planning unless the family is willing to discuss the issue openly. Tino Puri says: "Looking at the personal and sensitive nature of this discussion, it cannot take place in the board meeting and hence the role of the board is to not to have the discussion, but to encourage the discussion to happen."

Such a discussion is likely to cover what the role of the family is, what it is going to be, the internal power structure of the family, what standards of competence they are going to set for the business, what the rules of succession are in terms of who will be allowed to manage the business and who will not.

An increasing number of families want to engage seriously and deeply engage with this issue with the help of people they trust — for example, an individual member of the board, or a combination of a board director they trust and their family advisor. Another positive sign is that there is now greater interaction between enlightened and less enlightened families — through seminars and media — and this may lead to a further spread of best practices.

Balancing the interests of the family with that of the company is often extremely difficult. The quandary for many is how to adopt an approach in which the family's entrepreneurial leaders provide the dynamism and driving force for the business, engaging deeply in its strategy, but do not get involved in the day-to-day management.

Bridging the gaps

Succession strategies will be different from one organisation to the next. However, everyone can benefit from plugging certain gaps in the process. One of the biggest in India is the absence of truly independent nominations committees. Many times, they are constituted just to 'legalize' a predetermined decision. As M Damodaran says: "It is a matter of concern because people who ought to be discreet reveal information regarding succession candidates for positions that are opening up in the future, ultimately pressurizing the committee, and this is wholly undesirable."

Indian boards also face a cultural challenge. Experienced and well-respected people on boards can ask all the right questions and raise the right issues, but they often shy away from taking the right decision, especially when it is contrary to the view held by the chairman. This is often due to the close personal relationship they share with the chairman or the founder family.

One further gap exists in India — open communication. In many cases, it is almost sacrilegious to talk about succession with an existing successful CEO. An effective succession plan must be carried out with the CEO's blessing and should not be seen a threat or a slight.

Thinking ahead

Succession planning is about securing the future and making leadership decisions based on anticipated changes to company strategy and the market and economic environment in which it operates. It is important to continually assess whether the previously identified CEO designate is still the 'right' person for the job. Succession planning does not mean crowning the next CEO before the time is right, but building a systematic process that engages the senior management and board in the discussion. According to Mr Vaghul: "Succession is not for one person — it is about creating a huge talent pool from which it will be possible for the board to select one person."

Situations in which an individual inherits a leadership position by accident should never be allowed to happen. If companies do not put in place robust succession processes in the next few years, it is likely that the gains of the present may be lost in the days to come.

About Spencer Stuart

Spencer Stuart is one of the world's leading executive search consulting firms. Privately held since 1956, Spencer Stuart applies its extensive knowledge of industries, functions and talent to advise select clients — ranging from major multinationals to emerging companies to nonprofit organizations — and address their leadership requirements. Through 51 offices in 27 countries and a broad range of practice groups, Spencer Stuart consultants focus on senior-level executive search, board director appointments, succession planning and in-depth senior executive management assessments.

Spencer Stuart in India

Spencer Stuart's India presence began with the opening of its Mumbai office in January, 2006. Today the India business has a team of consultants operating from offices in Mumbai and New Delhi, supported by an adept research team with diverse experience. Consistent with the firm's presence elsewhere, the Indian offices address the leadership needs of both global and local clients at the senior executive and board levels, leveraging its deep knowledge of local industries and talent. Both Indian companies and multinational corporations have reacted very enthusiastically to this expanding commitment to India and today Spencer Stuart has an established practice across a wide gamut of industries and functions.

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