Where the board drives succession planning

At Hercules Inc., the philosophy is that strong boards make for strong management teams and solid succession plans. **BY DENNIS C. CAREY**

OUR EVERYDAY work with boards and on top-level assignments naturally leads to an interest and involvement in the CEO succession planning process. We see the good and the not-as-good: companies that have institutionalized a true and reliable process for developing their own leaders and those that have failed to "grow their own," or decide they need an outsider or different sort of leader for a variety of reasons.

Until recently, CEO succession planning was something of a neglected area of responsibility at many companies. Not unlike individuals — even highly successful ones with significant assets — who procrastinate when it comes to estate planning, succession planning has traditionally been a subject CEOs have postponed confronting. Yet maintaining an uninterrupted flow of leadership remains one of the CEO's most important tasks and is certainly at the top of the board's list of essential duties.

The convergence of a number of factors have led to a growing urgency on the part of CEOs and directors to establish a systematic succession planning process, including:

• Stronger, increasingly outsider-dominated boards that are more often taking the lead in the process on behalf of shareholders.

The board insists that there be someone who could step in and fill the CEO's shoes on a moment's notice, says Edward Carrington, Hercules' recently retired vice president of human resources.

• The vulnerability of in-the-spotlight public companies that lack a succession plan.

• Such events as the 1996 airplane crash in Bosnia which killed Commerce Secretary Ron Brown and several corporate executives who were on a business development mission; the sudden death last year of Texas Instruments CEO Jerry Junkins; and the abrupt departure of President Alex Mandl of AT&T, all of which highlight the importance, very much like having a will, of a clear succession plan.

Those companies that have overcome their initial reluctance or inertia when it comes to succession planning often don't know where to start. Since we subscribe to the philosophy that it's best to learn from the successes, as well as the mistakes, of others, we decided it might be a valuable exercise to take a look inside some prominent companies that appear to have a handle on the process to find out what has and has not worked for them.

Learning from leaders

With this agenda in mind, we invited some dozen companies — including MetLife, SmithKline Beecham, Mellon Bank, Caterpillar, Sunbeam, GTE, Hercules, Foster Wheeler, and Hewlett-Packard — to participate in our study. Companies invited to participate were not only leaders in their respective industries but had also demonstrated leadership in succession planning. In addition, we attempted to cover a variety of succession scenarios ranging from planned, orderly succession to the sudden death of the CEO. At the participating companies, we interviewed CEOs and top human resources executives.

One best practice that we have clearly inferred from our discussions with various companies is that a strong board is at the center of the process. While this

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has been a crucial factor in many of the companies we met with, for purposes of illustration here we'll briefly explain the board's role in succession planning at Hercules, a company many have recognized as having a strong and independent board. Just prior to his retirement a few months ago, Edward Carrington, then vice president of human resources, led us through succession planning Hercules-style.

An ongoing dialog

Like everyone else at Hercules, the CEO (Tom Gossage at the time of our interview in October 1996 and, since January 1997, Keith Elliott) is held accountable to the board for performance against his defined and agreed-to goals, including succession planning, one of a few key responsibilities. At a dinner with the board, held once a year, the CEO is asked to evaluate inside candidates and their readiness to succeed to his position. The board will insist on one "ready now" or "drop in" candidate — someone who could step in and fill the CEO's shoes on a moment's notice in the event of a sudden tragedy — and will always want the CEO and other top managers to demonstrate that they are "two deep" in any position.

During this meeting, the board will also expect the CEO to present other candidates who may be ready to assume the top position according to a longer time frame (three to five years), and to describe what the organization is doing to help the candidates broaden their array of skills and experience.

There is no succession committee per se as part of the board's structure (although there is a nomination committee, which would be involved in top management succession): all outside directors are involved in succession planning. While this once-a-year meeting deals with more than one issue, succession is clearly a top priority for Hercules' board and CEO.

The role is to challenge

How much confidence does the board have in the CEO to determine the course of succession? "The board has a great deal of confidence in the CEO," says Carrington, "but we have a strong board and the role of the directors is to challenge the CEO's opinion." If there were some divergence of opinion regarding who the CEO viewed as his successor and who the board had in mind, particularly with regard to any immediate successor or "drop in" candidate, Hercules' board would not necessarily defer to the CEO. A dialog between the CEO and the board would ensue, and continue, until a resolution was reached that satisfied the board.

Currently, since the chairman and the CEO are the only insiders on Hercules' board, the company has established a mechanism, the management advisory board, to expose others on the top-management team to the outside directors in order to give those key managers a more global view of the business as seen from a director's perspective.

The management advisory board consists of a total of five people: the executive vice presidents (business heads), the chief legal counsel, and the chief financial officer. It is an important element in the grooming process for leadership in the company. The board has regular access to the group: the group members sit in on board meetings, though the board can ask them to leave. In this way, the board can tap the management advisory board's expertise without risking slipping into the role of managing the company. The board's job is to oversee the management of the company.

Succession accomplished: Thomas L. Gossage (left) and his successor as Hercules Inc. chairman and CEO, R. Keith Elliott.

How much planning is enough?

How much time do the CEO and the board spend on succession planning? The amount of time regularly spent is related to how imminent a CEO's retirement is.

If the CEO is retiring, there would be a discussion, for perhaps an hour, regarding progress on a successor in a closed session (outside directors only) at every board meeting. Directors would want to know exactly what the CEO is doing to ensure a smooth transition and what they would need to do. As part of the grooming process for any CEO candidate, directors might introduce the candidate to people they know outside the company who could serve as mentors in various areas.

If the situation were less urgent, as with a CEO with no immediate plans to leave the company, the once-a-year board meeting might suffice. "In such a case, the emphasis would not be on rehashing candidates but on reviewing development plans against potential candidates in order to force an internal development discussion," explains Carrington.

One succession-related trend at a number of companies that Carrington finds "alarming" is that of directors taking over the CEO slot. "This indicates that the company had no real succession plan, no contingency plan, and in a public company, it can put the stock at risk," says Carrington, who views this approach as a band-aid solution at best.

Why do some companies, while acknowledging the importance of succession planning, find it so hard to actually accomplish? "Some boards are dominated by the CEO," says Carrington. "They leave it to him, and it doesn't happen."

In order for it to happen, it takes a tough board willing to confront the issue, continuously. Many boards, influenced by the pay and peer relationship with the CEO, are unable to take the initiative to tackle the issue of succession.

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Hercules' philosophy seems to be that strong boards make for strong corporate management teams and solid succession plans. The company's board, which has often been cited as particularly strong and effective, puts together its own agenda and works with the CEO, but does not answer to him. In succession planning as in other areas of board responsibility, directors want to avoid "management capture" at all costs.

The most effective relationship between the CEO and the board, in Hercules' experience, is one in which issues are resolved at arm's length — a cordial relationship, but not too cozy. This relationship clearly pays off when it comes to succession planning, a process that is long on careful planning and short on unpleasant surprises.