

Trustee Workbook **2**

APRIL

Leadership Succession Planning: A Governance Imperative

As health care continues on a rapid path to transformation, governing boards are being held to increasingly higher levels of accountability and transparency. One often-overlooked governance imperative is the board's responsibility to ensure cogent leadership development and succession planning. Leadership succession planning includes an ongoing, dynamic strategy to identify, develop and put in place capable leaders to meet organizational demands. This includes leaders for the governing board, CEO and other executive positions.

Leadership succession planning provides organizational continuity, resilience in the face of tumult and a strong base of leadership for the future. It also demonstrates that effective governance is in place, evidence of which is becoming more important as boards find themselves increasingly in the spotlight. Public scrutiny of board effectiveness, for example, includes the increased attention paid to succession planning by credit rating agencies that evaluate boards based on such governance practices. The Securities and Exchange Commission in 2009 also noted that one of the board's key functions is to provide for succession planning so that a vacancy in leadership does not harm the organization.

Other factors that call for effective succession planning include an increasingly competitive marketplace that demands leadership competence and continuity, executive re-

tirements, unanticipated changes in leadership, increased focus on ensuring diversity in executive leadership and a very competitive environment for talent acquisition.

PLANNING DIFFERS ACROSS SECTORS

While the aforementioned factors indicate a compelling need for succession planning, actual practice in health care and other sectors tells a different story. In its 2005 study of health leadership succession planning, the National Center for Healthcare Leadership found that three-fourths of hospitals lacked succession plans. In the National Association of Corporate Directors' 2012-2013 governance survey, slightly less than 40 percent of the public company board members classified their CEO succession plans as formal, with steps set forth in corporate documents. These studies show that in both the business

and health care sectors, formal succession planning is often inconsistent or negligible.

A 2012 study, *Governance in Large Nonprofit Health Systems*, found that of 14 large systems, 43 percent had adopted formal succession plans for both the board chair and committee chairs in addition to CEO and senior positions, and 29 percent had plans for the CEO and senior management only. Many board members and CEOs who had developed succession plans acknowledged that they were in the early stages of development and also recognized the critical importance of succession planning to the long-term success of their organizations.

In 2011, American College of Healthcare Executives CEO Thomas Dolan described the rate of CEO turnover and lack of succession planning as a crisis. Hospital CEO turnover on average is 17 percent, and the median tenure of a CEO is four years. This churn in leadership, along with a lack of succession planning, often causes disruption and instability in the organization. A CEO's departure can leave the organization in a vulnerable position on several fronts: increased com-

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BY KATHRYN J. MCDONAGH, LAWRENCE PRYBIL AND MARY K. TOTTEN

petitive risk, internal dysfunction and the possible loss of other executives after the CEO leaves. Because the CEO is a pivotal link to physicians, staff and community leaders, an unplanned departure can result in the organization's being diminished in the eyes of many stakeholders.

Some public companies are experiencing a governance maturation process that includes increasing recognition of the importance of leadership succession planning. When McDonald's Corp. lost two CEOs in rapid

Questions to Ask

Boards can use the following questions to guide discussions about succession planning.

1 Do we have a committee, such as executive compensation, talent development or governance, that focuses on the succession plan and leadership development?

2 Do we know the age and retirement plans of our CEO and top executives? Are there successors for the CEO and other senior officers?

3 Does the board chair take an active role in succession planning for the board chair and board committee leader positions?

4 Does the board employ an executive search or compensation firm to provide guidance?

5 Does the senior human resources leader support the board's work on succession planning? Is there a regular status report to the board?

6 Is there a successor who can be appointed should an unanticipated loss of the CEO occur?

7 Is the CEO acting as a leadership coach and creating a culture that values leadership development?

8 Has the chairman had a discussion with the CEO to explain that the succession plan is not a way to plan an early exit for the CEO?

succession, it was fortunate to have successors ready to step in. Other examples of effective succession planning include the recent appointments of new executives who were in the leadership development pipeline for Kaiser Permanente and Ford Motor Co. However, there are many other examples of boards being caught with little to no notice of a change in leadership, challenging them to maintain leadership continuity.

Because boards depend on the organization's chief and senior executives to carry out board policies and directives, ensuring the quality of organizational leadership is one of their most critical responsibilities. So why isn't succession planning more of a priority for boards when the results can be so important to the organization's viability and success? If selecting the right CEO for the organization is one of the board's most important roles, then why do so many boards fail to ensure that the right leadership is in place at the right time for their organizations?

REASONS FOR AVOIDANCE

There are many reasons why succession planning does not top the list of board priorities. An obvious one is a multitude of competing priorities. With transformative changes that require rapid, strategic responses, boards easily can choose to wait to address succession planning, particularly if the current CEO is highly respected. Boards don't always think about the sudden loss of a CEO and its impact on the organization. For example, the abrupt departure of CitiGroup's CEO resulted in disruption and instability due to lack of an effective relationship and communication between the board chair and CEO, and the absence of a transparent, board-endorsed succession plan.

A significant factor behind the lack of timely succession planning, particularly for the CEO position, is the uncomfortable reality of facing the inevitable change in leadership. According to a 2005 *Journal of Nursing*

Administration article, some CEOs are reluctant to lead the process due to their egos or a lack of comfort in the security of their role. This can be handled if the board chair and other board leaders have a frank conversation with the CEO outlining the importance of succession planning and assuring the CEO that it does not represent a threat to his or her position.

Another factor that makes leadership succession planning a challenge for boards is not knowing where and how to begin. Succession planning is not a one-time event, but rather a long process of building an organizational culture that values leadership at every level and plans for future leaders, especially for critical positions. It takes courage and understanding that the process must be transparent and, at times, confidential, meaning that the organization should be transparent about its commitment to leadership development and grooming leaders in the pipeline and yet maintain the confidentiality of individual leadership development plans. It is also important not to allow potential successors to compete aggressively for future positions, which can create dissonance and stress among the executive leadership team, negatively impacting its effectiveness. It is important that the board lead this process so that it promotes healthy and positive leadership development and team building.

RISK, STRATEGY RAMIFICATIONS

In a 2006 AHA Center for Healthcare Governance monograph, the authors note that boards often take a risk-management approach to their governance work, making sure to assess and mitigate risk in clinical, environmental, ethical and legal, financial, and safety and security areas. Ensuring leadership continuity is another way to avoid organizational disruption and its associated risks, and it requires boards to take a thoughtful, formal approach to leadership development and succession planning.

Many boards also understand the

importance of careful business strategy development, but don't always consider how critical effective leadership is to implementing strategy. The changes in health care make leadership succession planning even more important. A 2012 report from the Center urged trustees to focus on board and executive leadership development and succession planning to support leadership during the transformational changes organizations are undergoing. Changing payment and delivery models along with the shift to population health strategies require different leadership skills than those required in the past. Boards need to examine the changing environment and the corporate strategic initiatives being developed to address it and then seriously consider leadership criteria that will be required for the future. This analysis will clarify that succession planning now demands more than identifying new leaders likely to perform like those who were successful in today's or yesterday's environments.

Succession planning at Proctor & Gamble illustrates how one company made this process a key board priority. Former CEO A.G. Lafley and his board leaders began by defining four core responsibilities of the board. At the top of the list was CEO succession and leadership development, followed by strategic oversight, overall governance and enterprise risk. The company developed a comprehensive succession planning process, which included governance, CEO and executive leadership. The board compensation committee was restructured as the leadership development and compensation committee. The CEO took a strong role in this process and was an active leadership coach. Although not all board members saw the importance of succession planning given the other strategic priorities at that time, leadership development was elevated to the same level of importance as business strategy. This prompted a cultural change that supported leadership development at all levels of the organization. It in-

cluded a succession process that was ongoing, not episodic, and was supported by appropriate resources, necessary capabilities and systems. This resulted in a robust pipeline of leader candidates and when the time came, a successful new CEO appointment.

LEADERSHIP PIPELINE DEVELOPMENT

The lack of a pipeline of leadership candidates for governance and executive positions is a concern in a world of retiring baby boomers and a highly competitive field for talent. A global survey conducted in 2011 showed that only 15 percent of companies in North America and Europe believe they have enough qualified successors for key positions. Companies that recognize the value of a strong leadership development program are better positioned to attract and reap the benefits from high-performing leaders interested in continual growth.

It takes a team effort to lead organizations as complex as hospitals and systems. CEOs cannot expect to lead their organizations effectively on their own. It takes managers, executives and board leaders to work in a shared governance environment where diverse expertise and perspectives drive results. Successful leadership development programs provide opportunities for high-potential leaders to progress in their careers and give the board visibility into the pipeline of future leaders.

GETTING STARTED

Making leadership succession planning a board priority can be challenging. Therefore, the first step should be a board-level discussion about what it means to develop comprehensive leadership succession planning at board, CEO and management levels, and why it is important for the organization's future.

Recognizing that succession planning may be a sensitive issue, particularly for the CEO position, the board chair and executive committee also should discuss with the CEO the importance of the process to the or-

Succession Plan Development

Use these phases to structure the process.

- 1 Direct a board committee to educate itself about succession planning and develop a plan for board review. Include board members with human resources and business expertise, the CEO and the senior HR officer.
- 2 Develop a succession plan with a phased approach for implementation over several years. Prioritize phases based on organizational needs.
- 3 Develop a board leadership succession plan.
- 4 Develop a CEO succession plan that identifies several potential successors with accompanying development plans for each.
- 5 Develop a senior team succession plan, with development plans for each potential successor.
- 6 Institute an organizational development program to enhance leaders' skills and develop a pipeline of high-potential leaders for future advancement.
- 7 Implement an ongoing leadership academy and ensure that learning opportunities are based on needed leadership competencies.

ganization's future and the board's fiduciary obligation to ensure effective stewardship of organizational resources. Having this conversation can bring to the surface and resolve any feelings of uncertainty or doubt that may undermine the leadership succession process. Boards and CEOs also should recognize that working together to accomplish succession planning at all leadership levels leaves a legacy of excellence in leadership and long-term success and continuity for the organization.

Next, the board chair should assign a board committee to investigate and study succession planning and identify priorities, taking the opportunity

to learn from organizations that have done it well. This group should be led by a board member knowledgeable about human resources and management and supported by the CEO and the organization's senior human resources officer. Some boards also choose to engage a consultant who specializes in succession planning.

The overall succession planning process should be transparent to the organization. It is important for the board and CEO to broadly articulate the value of developing leadership for the future.

Comprehensive leadership succession planning typically takes months to put into place and many years to evolve. It requires developing an organizational culture that values leadership at every level. It also takes time to identify the most appropriate leaders for various positions and potential successors, and initiate a leadership development academy or program that incorporates specific learning opportunities for high-potential leaders. This may seem like a daunting task; however, the Advisory Board Co. recommends first pinpointing leadership gaps most critical to future success. Identifying key leadership positions and imminent retirements that require succession planning should be an initial priority.

Organizations can assist board oversight of succession planning by creating documentation that lists key positions, each incumbent's name and situation, the importance of the position for the future and potential successors. A full review should be conducted at least annually and documented to track progress and make changes. The assigned board committee should oversee this process and provide an update to the board.

Once critical positions are listed, top talent should be identified so successors and high-potential leaders can be groomed. Each successor should have an individualized leadership development plan that includes educational opportunities, challenging assignments and mentors, as necessary, to guide growth and develop-

Nine Succession Planning Metrics

Boards can adopt these metrics to track the progress of the succession planning process.

- 1 Percentage of internal succession plan candidates appointed
- 2 Percentage of gender and ethnic diversity in executive positions
- 3 Retention rate of high-potential future leaders
- 4 Percentage of leadership positions with viable successors
- 5 Success rate of newly appointed leaders after 24 months
- 6 Satisfaction survey results for leadership development program
- 7 Number of graduates of leadership academy
- 8 Succession plans for board and organizational leaders approved by the board
- 9 Effectiveness of board and organizational leader succession plans

ment. It is imperative to customize high-potential leader development so candidates are ready to step in when positions are vacated. It's also important to review incumbents in critical leadership positions. Sometimes an incumbent, such as a CNO or CFO, may be vitally valuable to the organization and likely to be courted by other organizations. Frank discussions with these candidates should occur and consideration given to implementing a retention plan, if losing that leader would be risky for the organization.

Tailoring orientation programs helps to strengthen the ability of new leaders to assume their roles. Talented leaders often flounder due to lack of a formal orientation and assignment of a coach to guide them. These approaches support standardization of leadership protocols and processes and foster leadership consistency throughout the organization. Ongoing performance feedback mechanisms also should be established that provide input from supervisors, peers and direct reports so that leaders can develop their skills with the insights of their constituencies.

Once the most critical board and executive positions are analyzed and successors identified, organizations should expand their leadership development capabilities by reaching further into the management ranks to identify and develop high-potential leaders. Developing an internal leadership academy or participating in professional or trade organiza-

tion leadership programs are ways to provide education and coaching. Another approach is to tap existing board members and executives with special expertise in leadership who can teach courses for developing leaders and provide learning opportunities for existing leaders as well.

TIME TO BE BOLD

Active involvement in creating and overseeing a robust succession planning process and organizational culture that promote leadership development at all levels is one way boards can measure up under increasing public scrutiny. Boards should begin by agreeing on the importance of succession planning and create a sense of urgency to move forward. Day-to-day business issues tend to dominate in many organizations, leaving leadership development and succession planning susceptible to budget cuts and inattention. In reality, unexpected leadership departures leave an organization at risk. Succession planning creates a strategic competitive advantage and should be at the top of every board's priority list. **T**

Kathryn J. McDonagh, Ph.D. (*kathryn.mcdonagh@hospira.com*), is vice president, executive relations, Hospira Inc., Lake Forest, Ill. **Lawrence Prybil, Ph.D.** (*lpr224@uky.edu*), is professor and associate dean, College of Public Health, University of Kentucky, Lexington. **Mary K. Totten** (*marykaytotten@gmail.com*) is a governance consultant and content development director, AHA Center for Healthcare Governance, Chicago.