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# Leadership Development and Succession in Employee-Owned Companies

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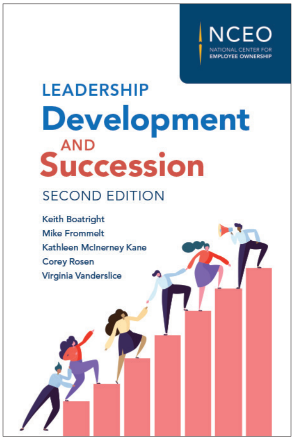

# 1

# Leadership Development and Succession in Employee-Owned Companies

*Virginia Vanderslice and Kathleen McInerney Kane*

SUCCESSION PLANNING and leadership development are two sides of an integrated whole that is essential for companies that seek to fully leverage employee ownership and achieve long-term sustainability. This chapter defines succession planning and leadership development, underscores the value of integrating strategies for both, shows the necessity of both to support an ownership culture that can contribute to business performance, and provides practical guidance for companies wishing to undertake succession planning and leadership development. Further, we have profiled two employee-owned companies that have developed well-integrated succession planning and leadership development programs.

## Why Succession Planning Matters

Succession planning is the process of strategically identifying someone (internal or external) to take on a role that has been or soon will be vacated by the person currently in that role. Succession planning often has been addressed in terms of specific individual roles. When there is enough notice that a successor will be needed, companies either invest in developing an internal candidate or, determining no current employee will be prepared in time, seek an external candidate.

A complementary approach is to develop a succession system. A succession system is a process, integrated into a company's ongoing operations, through which every position that could cause the organization pain if there were an unanticipated departure is identified. A key component of a succession system is implementing a regular process of developing and tracking the growth of potential internal candidates for each position. As candidates are identified and developed, the company also strengthens its leadership capacity.

Planning for succession is important for any company to avoid the potential disruption that could occur with unanticipated departures of people in key positions. For employee-owned companies that have invested deeply in developing high-performance ownership cultures that have driven their success, it is important that leadership changes don't result in dismantling those cultures. Having ownership cultures that leverage the fact that employees are owners is often a competitive advantage the company would not want to lose.

When there is an unanticipated departure and a succession plan is not in place, chaos can ensue. As the company mobilizes to consider candidates, business and psychological dramas can unfold. For example, when key players defect, the company or department may grapple with uncertainty, remaining employees can grow anxious about how leadership changes will affect them personally, and initiatives can slow or grind to a halt for months, if not years, while the company reorganizes itself. It is not unusual in these situations for competitors to poach key employees or for customers to defect, having no confidence given leadership changes.

These disruptive scenarios play out over and over when companies don't have succession plans for either the CEO or for other key positions. For example, at BL Companies, profiled later in this chapter, the departure of the founding chief executive created significant challenges for the company and the senior leadership team because a clear and well-developed succession process was not in place. The departing founder had appointed, without consultation, the most senior person in the company to take over as CEO. Unfortunately, this person lacked the skills to lead a company of BL's size and could not garner the followership of members of the senior team. Luckily, there were two strong leaders on the senior team who stepped in behind the scene to keep the company going until the board, following a systematic process, appointed someone to replace the CEO.

These disruptive scenarios play out over and over when companies lack succession plans either for the CEO position or for other executives or department leaders.

## Phases of Succession Planning

There are three major phases of succession planning: preparation, identification, and integration. These occur when planning for the succession of one of the company's senior executives or for any role in the company that would put the company at risk if the incumbent role-holder departed.

### Phase 1: Preparation

During this phase, companies should define their values and culture and, ideally, develop a strategic plan defining the direction the company is headed. Ideally, the company also will define a set of leadership competencies, intended to support the culture and the firm's strategy, that all leaders are expected to demonstrate. Together, these will help to shape the profile of all of the firm's leaders. For example, one 100% employee-owned firm had thrived under a CEO and COO, both of whom were oriented internally to the company's people, culture, and processes. The CEO was a firm cofounder. Through a structured process, the leadership team, along with other key employees, reached consensus that given current competitive challenges and the fact that the company now had developed a strong infrastructure, the next CEO would need to be external-facing, building deeper market presence and stronger relationships in their market, while the COO would continue to have an internal-facing focus.

This also is the time, before preparing a profile, for the company to reflect on the organization's structure to determine whether changes need to be made, particularly if organization design changes could affect job profiles. For example, the founder of an ESOP company had successfully grown the company and developed a strong ownership culture. Like many founders, that CEO played many roles, including managing financial analyses and oversight, developing several layers of leaders, leading business development, and overseeing administration. Although the board initially thought it needed to find a successor who functioned like the founder, it eventually realized that as a much larger firm, no one person could fill all the roles the founder had filled. As a result, new senior positions were created, and the role and competencies of the CEO successor became more focused.

The final task in this phase is for the board, in the case of the CEO, or the appropriate team for other positions, to develop a profile of the next CEO or leader. A good profile includes both leadership and functional competencies, experiences, goals, and responsibilities of the role; leadership characteristics; and important relationships necessary to be effective in the role, now and in the future. The most challenging aspect of this process is to clearly define what will be needed in a leader three to five years ahead. When the current CEO or leader has been successful, there is a tendency to want to look for a successor who fits the same profile. Through a thoughtful, often structured, process (usually including, at a minimum, other members of the senior team), these groups can think into the future and delineate a future-focused leadership profile as well as clarify the responsibilities and focus that may be different than those of the current leader.

A carefully developed profile is deeper than a job description and forms the basis for a scorecard that employee-owners as well as board members can use to evaluate internal or external job candidates, or to understand the specific development needs of potential internal candidates.

## Phase 2: Identification

This phase begins with determining whether the firm will consider internal or external candidates—or both—for a specific role. Often, if there are one or more strong internal candidates, there is no need for an external search. However, in some cases, even when there is a strong internal candidate, an external search may be pursued to assure the board and employee-owners that the firm has found the strongest successor (see the section below titled "Insiders vs. Outsiders in the Top Executive Role" for a deeper discussion of the advantages and disadvantages of internal and external successors and when each makes sense). In the case of succession candidates for executive team slots, many companies conduct executive assessments of final candidates (internal or external) to assess a candidate's values, personal preferences, style, and tendencies, as well as any issues that may derail them. This also is the phase in which companies wanting to enhance the diversity of their leadership teams can make a focused effort to find and consider candidates whose social identity is different from that of the dominant group in their company.

## Phase 3: Integration

It is typical for a board, once a CEO successor is chosen, to believe its work is done. Integration is the phase that often gets shortchanged, despite the fact that it is the phase in which the highest rate of failure and CEO dismissal occurs.[1] Integration is more than what typically has been meant by "onboarding." The importance of spending time focused on integration is supported by research results showing that without a substantial integration process, external successors are likely to be dismissed within 18 months.[2]

The effective transition and integration of an external successor into the CEO role may take longer than anticipated for several reasons. First, it is common that additional members of the executive team will leave with the arrival of an external successor, which may cause confusion and disrupt decision-making. This may be because members of the executive team do not want to work under the new CEO or because the successor wants to bring in their own executives. Also, an outsider may lack intimate knowledge of the company's people, customers, and culture in addition to not understanding internal politics. A strong mismatch between the company culture and a new CEO can result in either the need to replace a number of long-term employees or the inability of the new CEO to shift the culture, both of which can hurt the company.

Several groups and individuals have a role in the integration of a new CEO. The board needs to articulate clear expectations about its goals and priorities for the incoming leader as well as expectations regarding reporting. Integration is facilitated further when the board asks the new leader how the board could be helpful to them in achieving company goals. Integration of any external successor includes internal stakeholders partnering with the new hire to help them learn the culture; understand the company's strategic goals and strategies, organization dynamics, and potential political pitfalls; and establish important relationships, both internal and external. If there

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1. Shenghui Ma, David Seidl, and Stéphane Guérard, "The New CEO and the Post-Succession Process: An Integration of Past Research and Future Directions," *International Journal of Management Reviews* 17, no. 4 (2015): 460–82.

2. Mark Byford, Michael D. Watkins, and Lena Triantogiannis, "Onboarding Isn't Enough," *Harvard Business Review,* May-June 2017.

were internal succession candidates who were not selected, the successor will need to determine whether those people will continue to be contributing team members who add value. If so, it will be necessary to build a relationship with each person who was a candidate to decrease the chance that they will leave. However, at times this result is unavoidable, whether a different internal candidate is chosen or an external candidate is selected.

Internal successors for any key role may face challenges related to moving up to lead a group of which they have been a part, changing power relationships and friendships, and learning to focus on leading rather than "doing the work." People moving into C-suite roles will have to extend their focus from their department or discipline to thinking about the whole company. CEO successors who have not been CEOs before will need to change their focus from working *in* the company to working *on* the company, Often, internal successors are changing their work identity, which can take some time. Previous peers may resist accepting the new identity and authority of an internal successor. These dynamics illustrate why it is important to include those who will be direct reports of the successor in the selection process whenever possible. In addition, a successor may need support in structuring initial conversations with their team or others to develop strong working relationships in the new role configuration.

## Insiders vs. Outsiders in the Top Executive Role

When a company does not have a well-developed succession system, particularly for the top leadership position, there may not be an internal candidate who is prepared to step into the role. If the decision is made to pursue an external search, additional issues may arise, such as

# About the NCEO

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We generate original research, facilitate the exchange of best practices at our live and online events, feature the best and most current writing by experts in our publications, and help employee ownership companies build ownership cultures where employees think and act like owners.

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