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Volume 3
**Developing
future leaders**



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The faces behind the boxes

Succession is part of every company's future. The question is when it will happen — and when to start preparing. Whenever that day comes for your company, a lot will depend on choices you made years before — and not just about who will take over the top job.

Consider the fictional example of two closely-held companies — Alpha Systems and Omega Associates — friendly competitors in the same industry and region. Both are busy with strategic planning and operations, and both teams know succession planning is part of their talent management imperative. But the similarities end there.

Omega's senior leadership and board are okay leaving succession to chance. In their view, they grow, hire, and promote all the time. At any given moment, they have a leadership cohort in place that knows how to run the business. If the pipeline ever breaks down, they can hire leaders externally, which is better than trying to create them. As the CEO has said many times, leaders are born, not made.

Over at Alpha, the executive team views succession as an integrated part of its planning process. Alpha leaders there have devoted a management retreat to defining their approach to management development. They know succession will put a new generation of people in charge of a company that may not resemble the current one very closely — and that planning, not faith, is the key to establishing a robust pipeline of capable new leaders. Most importantly, Alpha's leaders know succession isn't a linear progression of aligning people to job titles. They value "optionality" in their people — the potential to grow in multiple possible directions tomorrow, which in the long term outweighs the more tangible performance they demonstrate in their current jobs today.

Both companies in this example have made choices about the interlocking challenges of developing the next generation of leaders and structuring their compensation in a way that both encourages and rewards that development. About the only lesson in common between the two examples is how profoundly present-day decisions can affect the fate of each organization years or even decades down the road.

This is the third volume in a series on business succession planning. Earlier volumes have focused on the need to take the process seriously, and the ways structure, valuation, and financing can influence the choices that one leadership generation has when it's time for the next to take over. Through it all, the message has been clear — succession planning is about more than naming names. But you will need those names. Eventually. And you should be confident those people are ready and willing to occupy the critical roles that will carry the organization forward, not only at the top, but throughout the executive structure.

There's a reason this is called "succession planning" and not merely "succession." It's a process, not a moment, and it takes years of careful decision-making to set the stage. A company's current leadership is responsible for working to identify and prepare the next generation long before any nameplates change.

The forces of supply and demand are at play in succession planning. The supply element is focused on assessing and developing talent along defined principles so the people you see as your successors will be ready for their future roles, while the demand element considers compensation planning to make sure those rising leaders know you appreciate them, so they either join or remain with the company long enough to play those roles. Ideally, through a careful process of calibrating supply and demand, leading companies mobilize themselves to accelerate the development of their future leaders.

The decisions you make today won't determine every detail of your organization's future, but they will help define the breadth of your choices. As in the examples of our two fictional companies, the groundwork you lay now can make a difference between the succession you want and a succession you have to settle for.

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Management talent assessment and development

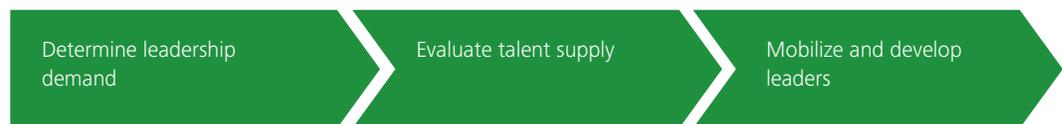
A family-owned sole proprietorship or another organization in the early stages of growth may approach management development in a very informal way. The founder-owner may rely on personal, one-on-one interactions to identify and train his or her eventual successors. There may also be special issues such as family dynamics and birthright that need to be considered. What differences separate that experience from the deliberate steps a more mature private business takes to identify and prepare its next generation of leaders?

A thoughtful management assessment and development approach proceeds from a set of guiding principles, progresses through a defined order of key processes, and measures outputs and value added along the way.

Chief among the guiding principles is active executive leadership involvement in the succession planning process. This is something the C-suite should not delegate, and in carrying out this mission, the company's top leaders should adopt an enterprise-wide approach. Furthermore, management assessment and development is not episodic. Leaders should execute continuously on their plan to bring the next generation along, and they should integrate succession with other elements of the company's talent strategy rather than treating it as a standalone process. Finally, while instinct and interpersonal relationships are important, this is often a job for data and analytics — even in smaller companies where everyone works closely together.

With that mindset in place, the job of finding and training leaders breaks down into three key processes, as detailed below.

Key processes in management talent assessment and development



- Assess growth objectives and competitive demands
- Identify critical functions and roles
- Define criteria for capability and potential
- Formulate leadership strategy

- Validate and review talent pool
- Calibrate talent against business objectives
- Determine priorities and risks

- Determine build vs. buy strategy
- Provide targeted development
- Monitor, measure, and adjust

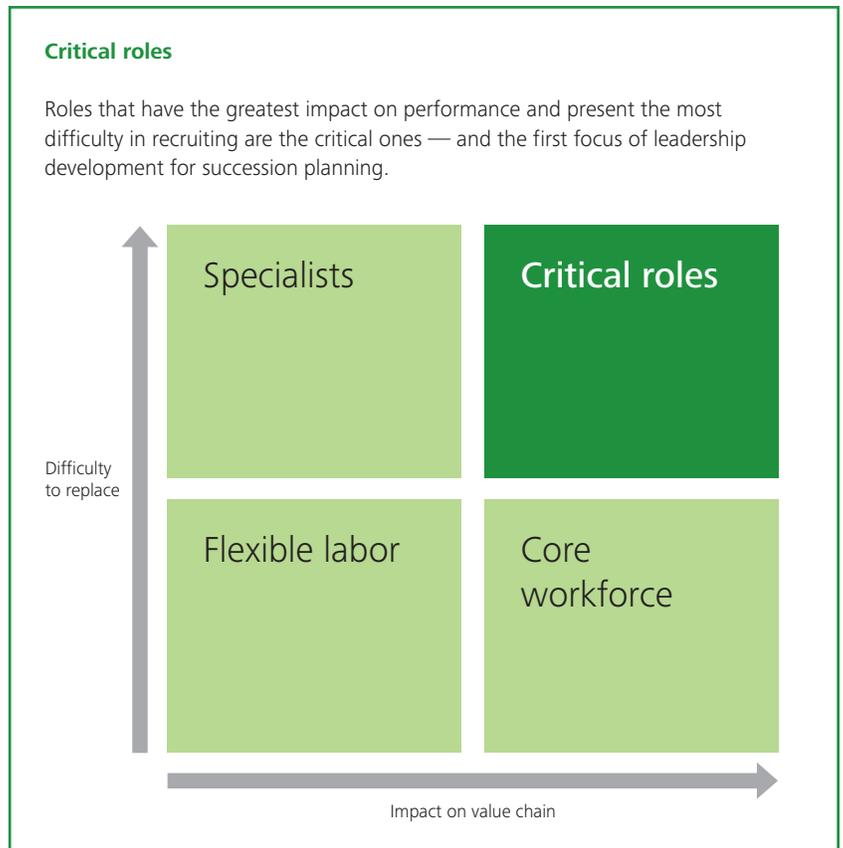
Determine leadership demand

There isn't a one-to-one correlation between the leadership roles you have today and the ones you'll need tomorrow. That's because the company will change over time — ideally for the better, through growth and innovation. No one can predict the exact nature of the business two years ahead of time, let alone a decade or more, but it's important to make your management plan adaptable and dynamic rather than anchoring it in a present-day reality that might not last. What are the core values that will persist in your organization through the changes ahead? And what is the business strategy that will guide it through those changes?

With this adaptability in mind, it's important to focus energies where they will do the most good. Traditionally, the process of determining demand in succession planning looks at only the top layers of the organization. However, it is useful to take a deeper look. To decide which roles should be "in scope" for succession, evaluate each role along two axes: How difficult is this position to replace? And how much impact does it have on the value chain? The low ends of those two scales represent flexible labor that, while valuable, can come and go without shaking the foundations much. The upper ends of those two scales identify the critical roles on which you should focus your investment of time and resources toward succession.

What will each of those roles demand? This is another opportunity to embrace flexibility. Think not only of the capabilities each person must have in the moment, but also the potential the person in each role must have to keep the organization agile. If a future leader has the appropriate amount of intellectual potential, people potential, motivational potential, and change potential, that leader will likely have the "headroom" to grow during his or her tenure in the role.

It is also important to think about diversity of the pipeline. As the global pool of professional talent becomes more diverse, a company's succession criteria should reflect that diversity. This helps not only to broaden the pool of likely candidates, but also to bring two important components of innovation — diversity of thought and perspective — to the future leadership of the company.



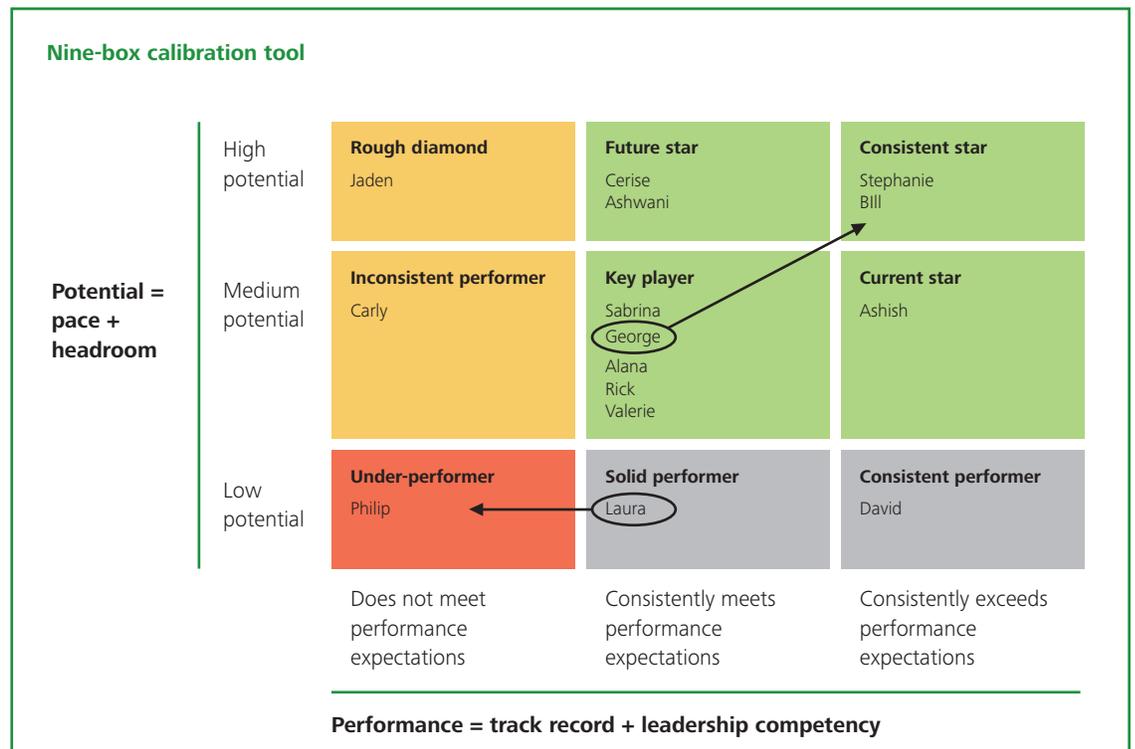
Evaluate the talent supply

Now it's time to begin applying these criteria to actual people. Note that in the Open Talent Economy¹ — in which access to talent relationships is more important than owning them — your pool of potential future leaders is not limited to people who are present-day, full-time executives. You may wish to include affiliated colleagues, alumni, or even competitors in this calculation.

Develop a common template for future leadership qualities and evaluate each person in your pool using that template. What information can go into that profile? A mixture of facts (previous positions, time in job, past performance metrics), informed predictions (likelihood to leave, time to retirement), and subjective assessments (such as the person's potential across the dimensions of change, intellect, motivation, and people skills). When you have compiled parallel profiles of each person in your management assessment pool, you can begin to think about where each of them fits in your plans for the company.

One way to approach that task is with a nine-box calibration tool. One axis represents potential, from low to high. The other represents actual performance, from those who don't meet expectations to those who exceed them. That grid yields nine locations from "under-performers" to "consistent stars." As you assign each management development candidate to a position in that matrix, you are taking the first steps in determining which people to invest in and the level of investment required.

Some organizations use validated approaches to assist in this assessment and categorization process. They can be useful, because data and benchmarks applied to a management workforce of any considerable size can balloon into a large data management challenge. While marshaling data can be valuable, the real value comes in the human decision-making that guides a mature management succession process. In the end, your goal is to create well-informed impressions of a person's potential — not an aggregate numerical score.



¹ *The Open Talent Economy: People and Work in a Borderless Workplace*, Deloitte Consulting LLP, September 2013.

Mobilize and develop leaders

One way to reconcile the tangible and intangible elements of this task into a holistic plan is to use the “Four Es” model:

- Build **experience** with “stretch” assignments and strategic job moves that give high-potential leaders a chance to learn new strengths
- Give people **exposure** by focused efforts at mentoring and executive sponsorship that tie personal assessment data to clear, specific objectives
- Align performance **expectations** with compensation and job mobility so natural incentives help drive people in their professional development
- Embrace executive **education** approaches that teach leaders how to think differently, instead of relying on traditional models that reinforce conformity

When analytics keeps this process based firmly in empirical fact — and when proper governance lets the company keep abreast of its ever-changing “depth chart” and the return on its investment in people — the principles behind the “Four Es” can help a company develop a rich lattice of growing leadership talent instead of a narrowly defined pipeline. A key for senior leaders is to own the process with support from HR, not to delegate it.

In the process outlined here, you’ll end up with categorized assessments of the people who may align with future leadership roles. Chances are those will be broken up, at least at the outset, by business unit. Recall, though, that one of the key principles of management development is to treat it as an enterprise-wide mandate. All those departmental assessment matrices need to come together into a single, enterprise-level calibration that shows the company’s entire leadership pipeline in a single picture.

This is a rewarding part of the process — and a tricky one, because it’s where turf can get in the way. As they assess each other’s teams, senior leaders need to be able to challenge each other’s assumptions and conclusions without becoming defensive. When everyone rallies around the broad pipeline view, it’s possible to build strategies that pinpoint which future leadership roles will respond effectively to internal development and which ones will require acquisitions from outside the current workforce.

And now the good part: With roles defined, people assessed, and strategies in place, the organization can work to create personal development plans for the actual individuals whose careers have been at stake all along.

This is where the difference between small-scale, ad hoc succession and methodical, process-driven management development can make a meaningful difference, because by planning, you’ve created lead time. For each person the plan embraces, you can apply different growth strategies that may have been impossible otherwise. For example, developmental career pathing can chart the sequence of experiences that will lead a person from where he or she is today to the role you would like him or her to occupy years from now. Or a combination of coaching, networking, and formal learning can “stretch” a person’s abilities in much the same way an athlete develops strength and flexibility through long-term training. You and your talent team can determine the effective way to push each person toward his or her potential—but because you’ve been deliberate in setting the terms, you have the luxury of time to make those decisions meaningful.

This approach often works because it is built around meaningful results. Like any business process, it must yield value you can identify—like an understandable line of sight into your future leadership pipeline, a defined vision of your organization’s leadership requirements and talent readiness, and actual lists of internal successors and sought-after acquisition targets. When you establish concrete expectations, you can communicate them, which can improve morale and loyalty where you need it most.

There isn’t a decision in the daily operation of your business you leave to chance. Determining who will make those decisions when you and your colleagues are gone shouldn’t be any more random. If you account carefully for the supply and demand of management planning — who needs what from whom — it doesn’t have to be.

What do you need from your future leaders?

- Strategic thinking
- Consistent drive for results
- Ability to lead and build talent
- Entrepreneurial edge
- Commitment to the company's mission and values

What do your future leaders need from you?

- To make an impact
- The opportunity to grow
- Competitive compensation
- Rewards and recognition that acknowledge value of contribution



Compensation planning

The principles behind leadership development and the principles behind compensation planning used to be separate. More recently, however, that distinction has blurred. Traditional pension and deferred compensation models have given way to rewards designed to promote a high-performance culture. A new generation of leaders values personal development and opportunity as a form of compensation in its own right. And there is greater recognition that effective leadership and business strategy alignment are what drive the shareholder returns that make everyone's compensation possible.

For all these reasons, management development and compensation planning should work together. When talent and reward strategies align with business objectives as part of a holistic strategy, performance can improve. And because succession planning is one of those objectives, a "total rewards" approach to performance can help secure the future of the organization and its value to stakeholders.

Retaining, motivating, and attracting employees

Compensation alone can't help you retain up-and-coming leaders if those people don't see their relationship with the company as a long-term proposition. You may have calculated what it will cost to keep each key person in your future leadership structure. Have you calculated what it would cost you to lose them? In the development of a business succession plan, the senior business owners should consider what impact the loss of each individual would have on:

- Sales and profits
- Operations
- Plans for expansion
- Customer relations
- Morale and loyalty of other employees
- Mentoring of successor managers
- Potential exposure of trade secrets and loss of employees to competitors
- Cost of recruiting and training a replacement
- Knowledge lost when the person departs

It can help not merely to identify vital employees, but also to afford them some level of participation in the succession process. The overall plan should account for their goals and expectations. That doesn't automatically mean granting every wish — but some creative compensation strategies, such as long-term incentive plans, can make a difference in retaining succession candidates as well as key employees that are not selected for a larger role in the organization.

Compensation strategies can also play a direct role in the effort to develop successors. If you ask someone to participate in a management development plan, short-term incentives can help motivate people to reach training, educational, and developmental goals, just as long-term incentive packages can help retain successors for years to come. The short-term incentive plan can also be used to motivate leaders to give the succession planning process the proper amount of time and focus.

Total rewards and leadership development — leading practices

In addition to compensation and benefits, organizations are focused on enterprise-wide strategic activities and other total rewards as tools for leadership development, performance excellence, and succession planning. Here are some practices that companies have found helpful.

- Review your HR capabilities and consider transforming the department from a compliance orientation to a leadership development orientation
- Add organizational development resources at the board level (if applicable)
- Create internal advisory boards of high-potential employees to solve strategic business issues
- Develop special project and innovation teams composed of future leaders to create additional capacity and growth opportunities
- Develop programs to train leaders to perform in multi-functional roles
- Provide outside executive coaching for key leaders

Types of compensation

Any organization that designs a compensation strategy should keep a number of considerations in mind: In the present day, compensation should not only be competitive and appropriate, but it also should stimulate, recognize, and reward excellence. From a succession planning point of view, compensation strategies can help retain and encourage important company leaders who have an important future role to play, but who will not be owners. There are several different approaches employers can use to help align employee compensation packages with succession planning goals, including:

- **Base salaries** — the fixed component of an employee's annual compensation and an important element in designing an attractive compensation package.
- **Short-term incentives**— annual bonuses that support the business strategy, are often tied to the company's financial performance, and reward employees for meeting business objectives. As noted above, short-term incentives can also be used to support the succession planning process.
- **Long-term incentives** — incentives tied to value creation and potentially long-term performance goals that not only link pay to long-term results, but also foster retention of key employees; this category includes stock options, restricted stock, cash-based performance plans, and "phantom stock."
- **Qualified fringe benefits** — non-monetary forms of compensation that provide a current deduction for the employer, create no income tax for the employee, and form an important part of the total rewards offered to attract and retain key employees.
- **Deferred compensation plans** — either a defined contribution or a defined later benefit that represents a contractual promise to pay at a later date, which can also be used to foster retention of important leaders.

Compensation strategies can help retain and encourage important company leaders who have an important future role to play, but who will not be owners.

Principles in action

Flash forward ten years in the histories of the fictional companies we introduced at the beginning of this volume: Alpha Systems and Omega Associates. The first thing you may notice is that several of Alpha's top executives used to work at Omega, because they were on Alpha's radar all along.

Because Alpha's leaders understood the distinction between performance and potential, they were able to focus their development resources on people with "headroom" — the flexibility, curiosity, and drive it takes to tackle lateral moves away from their comfort zones. That meant leaving many "high performers" right where they were, because those people were most likely to keep performing well in their current roles and not to respond as well to new challenges. The company has gone through several planned moves in its leadership structure, and has also weathered a few surprises due to deaths and defections. In each case, there was a pool of potential successors available, each of whom had been "stretched" through mentorship, cross-functional assignments, and formal training. The people who are poised to lead Alpha into the future include a number of long-term employees who stayed with the company because of meaningful rewards plans that recognized and drove their potential

and, through careful and deliberate planning, aligned their interests with the company's business growth strategy. Leadership by design is now part of the company's DNA, because its value has become so obvious.

At Omega, leadership by chance has led to a rougher time. It had high-potential future leaders within its ranks, but because it never identified and nurtured them, they grew to feel either bored or underappreciated. Many of them left, including people in whom the company had sunk costly investments in poorly structured compensation. Some of them are with Alpha now. At the same time, Omega zeroed in on current performance to build its succession plans, and as a result, a number of highly skilled executives were promoted into places where they weren't equipped to contribute. Some of those were labeled failures or burned out as a result. Some of them found places with Alpha as well. A wave of retirees is finding a huge tax bite in the deferred pay they were counting on, and the company has little to show in terms of ROI related to these payments because the plans were not tied to business success. Overall, the leadership ranks at Omega are in disarray. And tomorrow, Alpha and Omega both have make-or-break presentations to the same potential new major client.



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