Leadership Development and Succession in Employee-Owned Companies

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Succession planning and leadership development, which are two sides of an integrated whole, are essential for companies that seek to fully leverage employee ownership and achieve sustained strong business performance. This paper defines succession planning and leadership development, underscores the value of integrating strategies for both, shows the necessity of both in supporting an ownership culture that can contribute to business performance, and provides practical guidance for companies wishing to undertake succession planning and leadership development. It also profiles two employee-owned companies that have undertaken succession planning and leadership development.

Why Succession Planning Matters

Succession planning is the process of strategically and systematically identifying and developing internal people with potential to fill key leadership positions in an organization in the future. Although succession planning important for any company, employee-owned companies can gain a unique advantage by doing it well, as discussed below.

Turmoil often arises when a senior leader or anyone who leads an essential business unit leaves his or her position. Even with a successor fully capable of assuming the role, a leadership change will draw a department or an entire company into a major transition operationally as other key employees shift roles and the new leader gets fully up to speed, psychologically as individuals reorient themselves to a new leader, and culturally as the new leader and the organization adapt to one another.

When the succession process is not managed well and a successor or a group of prepared possible successors is not identified or ready, the situation is considerably worse. As the company mobilizes to consider candidates, business and psychological dramas unfold. The company grapples with uncertainty, key players defect, remaining employees grow anxious about how leadership changes will affect them personally, and initiatives slow or grind to a halt for months if not years while the company reorganizes itself.

These disruptive scenarios play out over and over when companies lack clear succession plans either for the CEO position or for other executives or department heads. For example, at BL Companies, which is profiled in this article, 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.

Going Deep with Succession Planning

To avoid the turmoil and the long-term adverse impacts that can come with poor succession planning and to leverage the potential of well-designed change, companies must go deep with succession planning. That means creating a robust succession planning process that starts with cultivating talent at many levels of the organization and identifying and developing multiple candidates for each critical position in the company. By beginning succession planning with leadership development, companies can avoid pitfalls associated with changing leadership, and employee-owned companies in particular can ensure that a strong ownership culture is sustained. A robust leadership development process has the added advantage of creating deeper leadership capacity within the firm beyond those people who actually move into vacated positions. This will serve the company well in general, and particularly if the company is growing and new leadership positions arise.

Insiders vs. Outsiders

Developing insiders is more effective than hiring outside talent to succeed into senior and executive roles. This is true for several reasons.

First, there is evidence that the complex process of successfully integrating executives brought in from outside takes a long time. While organizations expect integration to take about six months, it typically requires between 12 and 18 months, according to RHR International (2002). During a lengthy ramp-up period for a new senior leader, the company will experience confusion and delays. An insider, meanwhile, has the advantage of already being acclimated to the company.

Second, there is clear evidence that outsiders are more likely to fail, both at senior leader and middle manager levels. The hope is that the outsider will bring complementary experience into the company and will have insight that only an external person can have about how the company can do better. While it is true that outsiders can bring a critical eye and new ideas to a company, they lack intimate knowledge of the company's people, customers, and culture. It is also very hard to evaluate an outsider's values and how he or she will implement them as a leader, another factor than can jeopardize a new leader's success.

In fact, outsider CEOs are considerably more likely to be ousted by their boards. In 2003, 55% of departing CEOs were pushed out by their boards, compared to 34% of departing insiders, according to the consulting firm Booz Allen. Senior executives fail, in general, 34% of the time when hired from the outside and 24% of the time when hired from inside (Kelly-Radford 2001). This research was corroborated by another study that found that external hires have a failure rate of 22%, while internal promotions have a failure rate of 14% (Rioux & Bernthal 1999).

In Collins' (2001) landmark study of companies that made the extraordinary transition from "good to great" performance, 10 of the 11 companies that successfully made the transition were led by CEOs who came from within the organization. In comparison, companies that did not make the transition tried outsider CEOs six times more often. "Larger-than-life, celebrity leaders who ride in from the outside are *negatively* correlated with taking a company from good to great," Collins writes (p. 10).

And finally, organizations that rely on external candidates to fill middle-management positions (more than 25% from external sources) have almost double the turnover of organizations that rely on internal promotions (Bernthal & Wellins 2001).

This research strongly suggests that companies should focus on internal rather than external candidates for senior positions. The underlying assumption, of course, is that companies make the investment in developing people to create a rich pool of internal candidates.

In spite of these research findings, there may be times when a company's best course of action is to select an outsider. Perhaps a position opens unexpectedly and needs to be filled immediately, but no internal candidates have the requisite skills or experience for the role. Perhaps a company has not yet made the investment in development that would create a pool of qualified candidates. Or perhaps the company is creating a new line of business or going in new direction, and no one within the company has skills or experience in the new area. In all of these situations, it may make the most sense for a company to hire from outside.

Companies that place a high value on their culture and how leaders lead have offered outsiders roles as consultants for a six- to twelve-month period. Over the course of the consulting engagement, the company can directly observe not only the person's knowledge and skills but how well the person's style and values fit with the company's current or desired culture. Such a trial period enables a company to limit the risk that may be involved in hiring an outsider.

Connections Among Leadership, Organizational Culture, and Business Performance

Even more important for employee-owned companies is the relationship among employee ownership, company leadership, organizational culture, and company performance.

Simply put, top leaders strongly influence whether a company has an ownership culture. And the presence of an ownership culture combined with employee ownership leads to better business performance. This relationship has important implications for going deep with succession planning, because it implies that successors to senior positions should have experience contributing to as well as understanding the core components of an ownership culture.

Research on ownership culture points to some clear conclusions (Rosen & Quarrey 1987). Instituting