Succession: The Biggest Risk Factor

By Hal Shear

As New Jersey banks emerge from two years of financial turmoil, bank directors recognize that leadership is, as usual, the most important going-forward decision they face. This is particularly true for state-headquartered banks deriving 100 percent of their business from state-centered activities.

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In many cases, these are banks with less than $1 billion in assets, requiring them to nimbly execute in markets where they are often outspent for customer acquisition. Superior leadership – both now and into the future – will determine not only how well New Jersey banks perform, but whether or not they even survive. Bank regulators give high priority to CEO leadership in their examinations. That makes choosing the right CEO a bank board's most significant responsibility.

Having a succession-planning process in place is crucial to leadership continuity; having the *right* succession plan is what it takes to mitigate the serious risk of compromising the strength of that leadership. Yet the number of smaller companies that have developed any sort of formal succession process reflects a slow response among many boards to address that risk.

The problem has lingered for years and notably in financial institutions. In 2009, a National Association of Corporate Directors (NACD) Public Company Survey found that 44 percent of the companies polled had no succession-planning process in place. Most in that group were smaller public companies, many of which were in the financial services industry. According to NACD's just-released 2010 Private Company Survey, which included a considerable number of financial services firms, only 50 percent of responding companies had emergency plans in place for replacing their CEOs, and only 43 percent had long-term (three years or more) succession plans. Furthermore, an independent survey of publicly-traded members of the New Jersey Bankers Association (representing approximately 50 percent of in-state banks) reveals that many are already – or soon will be – facing succession issues: more than one third have CEOs who are over 60 and/or have served as CEO for more than 10 years.

While surveys help to quantify the percentage of companies with succession plans, they do not reflect the effectiveness of those plans. Bank boards often approach succession planning by focusing on the creation of an elegantly worded document, rather than a process. By taking the document-driven approach, what they often produce are generic, one-size-fits-all plans that may or may not identify the right CEO for their company's needs. A process-development approach, on the other hand, factors in the distinct external forces confronting each bank – including geographic markets and local economic pressures – as well as its internal talent pool and its own strategic response to those dynamics, which are unique and need to be a part of the overall succession plan.

THE PROCESS

First, board and management must devise and agree on a winning business strategy – usually three to five years out – with clearly defined operational and financial metrics as well as goals for regulatory compliance, employee morale, ethics, diversity and turnover, customer satisfaction, corporate social responsibility, business development, tone at the top, executive talent development and long-term value creation. These metrics, designed in terms of measurability, attainability, relevance, and time-frame of all agreed-upon strategic goals, are essential to another critical part of the process: assessing the CEO's progress and success each year in achieving those goals. Usually, the governance or compensation committee oversees the creation and implementation of this annual performance evaluation, which should address not only the recent year's outcomes but also how they relate to the bank's evolving strategy.

Once the overall business strategy and performance metrics are defined, the next step involves constructing a plan, from which the succession process will emerge. This step requires a leader, typically the CEO. The board contributes by helping to flesh out what questions need to be asked and what factors considered in arriving at an effectual plan design. For example, are the CEO's personal style and business methods a match for the bank's chosen strategy? What is the size and composition of the existing leadership talent pool? Is the bank meeting the board's performance expectations? How dramatically are internal operations and/or the external environment likely to affect overall performance during the strategic planning cycle? What is the hit-by-a-bus emergency CEO replacement plan? Does the tone at the top or the bank's risk culture exceed industry norms? What is the regulatory perspective?

As the planning process unfolds, the board will eventually face the insider-vs.-outsider and horse-race questions. Many directors – supported by recent academic research – favor insider candidates for CEO succession, although particularly for banks, there is no clear-cut answer to the question of which is preferable. An insider may do better when the bank is strategically strong and an outsider when it is weak. Each board will first need to decide if the bank's talent pool has sufficient depth and potential to mature during the development time available. Depending upon their findings – and given the fast changing dynamics of

the financial services market – the board may then have to consider both options to find the best match for their established strategy. As for the horse-race option, few banks will have deep enough talent pools to consider that alternative.

When it comes to defining criteria for the selection process in a succession plan, specific individual competencies and traits, or "fit" – rather than boilerplate general qualifications – is what is needed to facilitate objective decision-making. In addition to business/industry expertise, examples of specifics to be considered for all candidates should include decision-making, leadership characteristics, behavioral, ethical and emotional aptitude, and leadership style.

On the other side of the equation, those charged with selecting the CEO need to be able to make the best candidate match with the company's three-to-five-year strategy and to steer clear of subjectivity and short-term expediency when making their choice. This is best achieved by incorporating a defined decision framework into the succession process and putting directors, not recruiters, in charge of implementing that process.

Finally, a proper succession process should include a transition plan for assimilating the new CEO into the organization and a continuous development program for the executive talent pool. After their company's succession plan is in place, the board then needs to revisit, refine and refocus the process on a regular basis. The first order of business for every board, though, is to make sure it has a hit-by-the-bus plan in place before its next board meeting adjourns. ■

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