

*By: Dr. Gregory McKee, Director, Quentin Burdick Center for Cooperatives,
Department of Agribusiness and Applied Economics, North Dakota State University*

Introduction

The chief executive officer (CEO) is key to the success of a cooperative business. These individuals manage a complex set of objectives, balancing returns at both the corporate and member levels. Their decisions are key to the firm's financial success and they frame the cooperative's unique culture. The selection of the CEO has far-reaching consequences and is one of the most important duties of the board of directors.

A substantial percentage of the senior leadership of U.S. agricultural cooperatives was born between 1952 and 1958, and they are members of the "Baby Boom" generation. A recent Met Life Mature Market Institute survey highlights some urgent trends for cooperative business leadership (MetLife Mature Market Institute, 2010). The survey reports that a majority of Boomers are still working (74% of men, 64% of women) whereas 8% are fully retired. Although employees in this age group anticipate retirement, most plan on working until age 66. Approximately 10,000 baby boomers reach retirement age each day; a process that will continue through

2030. This trend highlights the need for executive succession planning.

Executive succession planning is not simply about replacing the chief executive. Instead, successful planning involves defining the characteristics desired for the CEO, aligning CEO succession with business goals and assuring that a pool of qualified candidates exists. A successful plan delivers one or more viable candidates when the cooperative needs them. It may include lists of important search procedures and of core competencies required for planning to meet the strategic needs of the company. A successful succession plan is most likely to be developed when the board and senior management have conducted significant introspection about the objectives and resource requirements of the cooperative. Succession planning also involves the formation of a short-term or "emergency" succession plan, providing resources and incentives to develop mid-level managers and making plans to "on-board" (orientate) a new CEO. Progress in CEO succession planning varies across cooperatives. Many cooperatives have at least discussed the topic in board meetings.

Others have developed an emergency plan for the unexpected departure of an executive, and a few have developed a formal plan for the replacement of the chief executive. The cooperative's future business environment should also be considered when developing a plan. This includes the age and size of the company, the industry in which it operates, and the industry-wide talent pool. Approximately one to two years may be necessary to complete the process of developing a succession plan infrastructure.

This paper presents the key themes in a successful executive succession processes. While CEO succession planning is unique to each cooperative, these themes should be borne in mind by cooperatives anticipating CEO succession. First, this paper examines the relationships the CEO oversees within the cooperative and identifies how a successful CEO adds value in those relationships. Second, strategies for developing internal talent and identifying external candidates are described. Finally, the role of the board of directors in the succession planning process is discussed.

The Role of the Chief Executive

A cooperative's CEO performs many functions. These include organizing the cooperative's assets and human capital to provide benefits for the members. The CEO also coordinates information and resources such that the board's strategic plan is achieved. The CEO

communicates with key stakeholders within and outside the cooperative. The CEO creates the incentive structure that motivates employees to achieve the cooperative's objectives. The CEO also participates in hiring, training and evaluating employees. Finally, the chief

executive observes the performance of the cooperative, compares it with established standards, and redirects the policies or processes of the cooperative when necessary.

These functions are performed within the context of a variety of relationships.



First, the CEO is the public image of the cooperative. The membership perceives the chief executive as being ultimately responsible for the operation and direction of the cooperative. The CEO manages the relationship with all of the cooperative's stakeholders: suppliers, creditors, the community and government. A successful change in the chief executive means the relationships between the cooperative and its stakeholders may continue. Second, the CEO is the liaison with the membership, communicating operational and strategic decisions and eliciting input from the member owners. Since most members have substantial financial

investment in their cooperative, members are motivated to keep abreast of the cooperative's operations. The CEO provides information in ways that empower members to make informed policy decisions for the cooperative or to select members to serve as directors. The CEO also inspires loyalty to the cooperative and trust between the membership and cooperative. As discussed by Anne Reynolds in another section of this website, member trust increases the capacity of the cooperative to provide value.

Finally, the CEO sets the tone for how people within the organization are

treated. In most cooperatives, the CEO oversees hiring and firing employees and organizes job activities. A successful CEO gets the right people on the bus, the wrong people off the bus and gets everyone on the bus in the right seat. The CEO also sets compensation and establishes procedures that affect employee performance. A change in the CEO is likely to affect every employee. New policies and practices will ensue and operations may be reorganized. A CEO candidate's ability to build an effective team and manage human resources should be a top priority in succession planning.

Driving Forces for Succession Planning

In 2009, the chief executives of 160 cooperatives responded to a survey asking about their experiences with CEO succession planning. Responses were obtained from representatives of cooperatives in a variety of industries and revealed a range of reasons for participating in the succession planning process. When asked why respondents engage in CEO succession planning, 87% indicated the most important reason was so that the cooperative could continue its current business activities. Half of all respondents indicated there were financial reasons; 51% stated they hoped to improve or maintain the financial performance of the cooperative. Approximately one-third of respondents said they considered the strategic implications of a change in the chief executive; 30% said that a change in the chief executive would help the cooperative adapt to a changing business environment. Regardless of their motives, respondents were generally optimistic about having a successful conclusion to the process; 75% were confident a candidate could be identified with skills similar to the current chief executive.

The survey results also provided insights into the demographic trends driving CEO succession. One-quarter of respondents indicated that their CEO was eligible for retirement within zero to four years while another quarter of respondents indicated the CEO was retirement eligible in five to nine years. In other words, fully one-half of all chief executives expect to be eligible for retirement within nine years of the 2009 survey. Retirement of the CEO is obviously a driving force for succession planning. A retirement announcement may occur unexpectedly but it can often be anticipated by the cooperative. Boards of directors should consider how long it may be until their CEO is eligible for retirement as well as estimating their likely retirement time.

The survey results also confirmed the fact that there is a lot of institutional knowledge at stake in CEO succession. For 20% of respondents to the survey, chief executives had held that position for more than 20 years; for 36% of respondents, between seven and

20 years. Surprisingly, there was no statistically significant relationship between the length of tenure of the CEO and the amount of effort spent on succession planning.

The survey results emphasize the need for cooperative boards of director to become actively involved in CEO succession planning. The majority of cooperatives can anticipate CEO succession within a decade, and many of the successions will involve a long-standing CEO. As part of this effort, boards will want to consider how to capture the current CEO's institutional knowledge and the desired characteristics of a replacement. Most boards consider their current CEO to be successful and seek to identify candidates with similar traits. However, the survey results also indicate that succession can be viewed as an opportunity to adapt to changes in their markets or to adjust their financial performance. As part of the succession planning process, the board should consider whether the skills needed in the past will be the ones most needed in the future.



Developing Internal Candidates

Cooperatives may choose to hire a potential successor for executive positions from among individuals currently employed at the cooperative. There are pros and cons to internal candidates. When a current employee is hired, the members and stakeholders of the cooperative have greater knowledge of the decision-making process of the candidate. In addition, the new CEO will be familiar with the cooperative's values, culture and unspoken ways of conducting business. The board of directors may anticipate that an internal candidate is more predictable in his or her behavior and more likely to continue relationships with major vendors and members. On the other hand, an internal candidate may have a more narrow perspective on marketplace possibilities. If there are two or more internal candidates, there will be an automatic loser, which may lead to tension and dissent. The internal candidate may also place too little emphasis on change, ending up with a "business as usual" mantra.

More than two-thirds (68%) of respondents to the survey agreed someone within the cooperative could be developed to serve as the next chief executive. Respondents also showed a strong preference for internally-developed candidates. Respondents were asked to indicate whether they would prefer an internal candidate to an equally qualified external candidate. Nearly two-thirds indicated they would prefer the internal candidate. The strength of this preference depended on at least two demographic factors, however. Cooperatives headquartered in areas with relatively large populations or cooperatives serving relatively large memberships tended to prefer

internal candidates less strongly, although still more than external candidates. Presumably this reflects the opportunities these cooperatives anticipate for recruiting successful leaders from other businesses, including other cooperatives.

Given the preference for developing internal candidates, it is important that cooperatives make specific efforts to encourage employees to develop the skills and attributes necessary for successful management. Activities such as mentorship, annual reviews, and access to professional development opportunities may contribute to this process. Mid-level managers must be challenged beyond their comfort zones in order to build the skills needed at the CEO position. The board should also consider how to provide incentives and resources to the current CEO to recruit and develop the level of talent needed for future internal CEO candidates.

Respondents to the succession planning survey indicated that many cooperatives are making progress in mid-level manager development. Most cooperatives indicated they make strong efforts to mentor (58%) and conduct annual reviews (65%) of employees, while only 10-15% of cooperatives reported making little effort on these activities. The survey results indicate these activities are more likely to be done in cooperatives with relatively more members. Most cooperatives made sure employees keep in contact with key stakeholders (66%), and most co-ops provide access to professional development activities offered by sources outside the cooperative (66%). These activities are more likely to happen in cooperatives with larger sales volume and relatively

more employees. Finally, about one-half of cooperatives cross-train their employees, making sure that one employee is proficient in completing the job duties of at least one other employee. More cross-training effort was made in relatively smaller cooperatives. In this way, relatively small cooperatives develop a shared, casual awareness of the core competencies each employee has. All of these efforts develop and preserve institutional knowledge.

Cooperatives can also deliberately identify specific employees as executive candidates. The survey responses show that when this happens, the effort dedicated to mentorship, reviews, cross-training, key contact, and training activities tends to increase. In addition, about one-quarter of cooperatives indicated they make a conscious effort to design a career path within the cooperative. About 40% of responding cooperatives had created a formal plan to develop core competencies within the co-op that suit strategic needs. Together, these results suggest a typical executive development strategy is to allow each employee to demonstrate their capacities over time in current job descriptions, and then to select an internal employee based on overall capacity rather than from a leadership track. This reinforces the idea that succession planning for the CEO can be part of a larger process of succession planning for key positions. Interestingly, professional development strategies for key employees appears to be unrelated to the size of the cooperative. Based on the survey responses, employees in any size co-op are just likely to interact with their management to develop a formal plan to develop professional skills.



Identifying External Candidates

Many major corporations have selected internal candidates to replace their CEOs, and cooperative firms show similar tendencies. Internal candidates were preferred more than two to one over external candidates in the survey of 160 North Dakota and Minnesota cooperatives. Nevertheless, searches for candidates external to the co-op do occur. For instance, the CEOs of smaller cooperatives are often tapped as leaders for larger companies. Hiring an external CEO candidate exposes the cooperative to practices used outside the company. These individuals may be more likely to make adjustments to the current way of conducting business. Searching for external candidates for the chief executive position may be a good way for boards to diligently complete the candidate screening process. It also helps avoid the illusion that a focus on current employees is sufficient, even if it appears there is an outstanding candidate ready for the chief executive position.

It's important to be aware of the effort required to search for external candidates. Personal contacts may be used, but a common strategy is to hire

an executive search company. These companies have detailed, specific knowledge about a given geography and a variety of personal contacts within the industry, and begin to evaluate whether job candidates would fit into the culture of the cooperative. The recruiters are paid for their search effort. These services are available from private firms and may also be available from a federated cooperative or a trade association. For instance, CHS Aligned Solutions and the National Rural Electric Cooperative Association provide these services. The survey results confirmed the value of recruiting services. Half of the cooperatives that participated in the survey had used an executive recruiting service in the past, and a similar number indicated it was likely they would use that kind of service again. The likelihood of using an executive recruiting service was also positively correlated with the amount of time the board invested in succession planning. Nearly three-quarters of cooperatives that have used these services previously indicated they were useful.

Cooperatives were surveyed about the effort they anticipated would be

required to conduct the next executive search. First they were asked how long they thought it would take to complete the search process. About 60% believed it would take six months or less. They were also asked about the geographic scope of the search. Respondents generally believed a regional search, as opposed to a local (or city-based) search, would be required. Given this level of effort, respondents were asked if the cooperative anticipated hiring an executive search firm. Nearly half (47%) indicated that was very likely. Although the executive search firm will conduct many of the search related activities, this response reinforces one role of the board – the ability to articulate a vision of what the candidate should achieve and how they should interact with the membership. The data show that using executive search firms is also an important predictor of succession planning effort. Applying statistical techniques to the survey response data showed a positive relationship between doing more succession planning activities and using executive recruiting services. This suggests executive search firms are complements to, not substitutes for, succession planning.

The Role of the Board of Directors

Selection of the CEO is the most important activity of the board of directors. Planning for CEO succession is a board responsibility and the board should not wait for the CEO to raise the issue. There are several components to the board's role in succession planning. First, every board should develop a short-term succession plan to minimize business interruptions when the CEO position becomes vacant. The short-term plan should define the chain of command and contain a list of contacts such as lenders, warehouse inspectors, brokerage firms and other business affiliates that must be notified. When implementing the short-term plan, the board should convene a board meeting as soon as possible. During the meeting

the board can decide whether an outside interim manager is needed, whether an audit should be conducted and whether an outside recruiting firm will be employed.

In addition to the short-term or emergency succession plan, the board should have a written formal plan for CEO succession. This plan should describe the desired characteristics of the CEO and the key responsibilities of the position. It should either contain a job description for the CEO position or, at the very least, summarize the information needed to prepare a formal description. The succession plan should summarize the board's philosophy toward internal and external candidates. It should also identify

the individuals who could potentially perform well in higher roles and document their training and development progress. The succession plan should also identify outside executive recruiting firms that are familiar with the cooperative industry.

The survey results suggest that success in succession planning effort is impacted by board size. Almost 60% of boards with 10 or more directors participated in multiple succession planning activities while a third did at least one planning effort. In contrast, 70% of boards with nine or fewer directors did nothing or only one succession planning activity. This may suggest that some of the succession planning efforts are performed

The Role of the Board of Directors, continued

by board committees that are more easily formed within larger boards. Cooperatives with smaller boards might consider employing outside consultants to help with the mechanics of developing the succession plan.

The board of directors' role is not limited to the development of the succession plan. When a vacancy occurs the board is also directly involved in the candidate screening process. The board makes the final selection from among the candidate pool of who will serve as the chief executive. The steps in this process include developing a skills requirement profile for the next chief executive, identifying and assessing candidates internal and external to the firm, and engaging in a confidential search process. In deciding between internal and external candidates, some boards identify the short list of external candidates and interview one or more of the outside candidates. An assessment of the internal candidates is then made and if the skill

sets of the internal candidates are not substantially different from the external choices, the external search is terminated.

Survey responses indicate that steps associated with identifying executive candidates challenge boards. When rating the ability of boards to identify external candidates for chief executive, respondents provided an average score of 2.0; the ability to identify internal candidates received a score of 2.6. Similarly, the skill of interviewing CEO candidates received a score of 2.0. Activities that expose the executive candidates to the board may improve director capacity to participate in the candidate screening process. In addition to evaluating candidates, the board must be able to clearly articulate a strategic direction to any executive candidate. As described by Phil Kenkel, Ph.D. in another section of this site, a board that has a clear strategy can more easily navigate its way through decisions on capital expenditures, acquisitions and

divestitures. This also applies to succession planning. A board with a clear consensus on strategic direction will have a much easier time defining the desired skill set and evaluating CEO candidates.

In addition to these vital roles in the succession planning process, the board of directors has a role in "on-boarding" the new CEO. The board should ensure that the new CEO receives specific feedback early in his or her tenure. In some large corporations, new managers receive a formal integration assessment after three months. A detailed evaluation should contain specific measures and constructive feedback from board members. The ability to do this well improves the capacity of the board to articulate the expectations they have for the new CEO. The board should also assist the new CEO in reconnecting key relationships. While the CEO may take the lead in communicating with key business contacts, the board can assist the CEO in meeting and interacting with key members and customers.

Summary

Succession planning is not simply replacing the chief executive. Instead, it is a process of identifying the skills and traits desired in a CEO, developing mechanisms to identify quality internal and external candidates, encouraging the development of mid-level managers, and preparing to on-board the new CEO. In conducting the succession planning process, it's important to think about the relationships a cooperative CEO oversees. It is within that context of relationships, and the skills required to manage them, that the value of a superior CEO becomes apparent. Those superior executives can come from within the cooperative or from the outside. The CEO succession process is the responsibility of, and in fact, is one of the most important responsibilities of the cooperative's board of directors. While the survey results indicate that cooperative boards are making progress, the majority of boards are investing too little time in this critical area.

Dr. Gregory McKee presently serves as director of the Quentin Burdick Center for Cooperatives, Department of Agribusiness and Applied Economics, North Dakota State University. McKee earned his Ph.D. in agricultural and resource economics from the University of California at Davis and currently teaches courses in cooperative business management and agribusiness industrial strategy at North Dakota State University. He is a member of the American Agricultural Economics Association, the Western Agricultural Economics Association and the Association of Cooperative Educators. McKee's research projects have been supported by the USDA-ERS, the North Dakota Association of Rural Electric Cooperatives, the Agricultural Marketing Resource Center, and the North Dakota Farmers Union.

Dr. Phil Kenkel reviewed this article for CHS Inc.; he holds the Bill Fitzwater Cooperative Chair at Oklahoma State University and is the current editor of the Journal of Cooperatives.

Further Reading

"The MetLife Study of Boomers in the Middle: An In-Depth Look at Americans Born 1952-1958," accessed August 1, 2013, <https://www.metlife.com/assets/cao/mmi/publications/studies/2010/mmi-boomers-middle-study.pdf>