



## Succession Planning and Profitability

### Summary

- Although succession planning programs have come a long way, they still lack a key ingredient, a direct focus on the financial acumen of executives, which will help predict their impact on enterprise financial performance and valuation
- Succession planning programs' impact on profitability can be improved by incorporating the use of the concept of the financial signature of an executive and teams for assessment and development purposes
- This is particularly important as these programs are broadened to encompass mid-level management that has had no P&L or even cost center experience to use as a guide to future P&L performance
- Filling this gap will improve profitability performance and improve the enterprise's valuation outcome.

### Recommendations

- Broaden the scope of your succession planning efforts to incorporate a formal focus on financial acumen
- Include financial acumen training in your executive development programs
- Assess financial acumen and financial signature formally as part of your SPPs at both the top and the middle levels of management

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- Perth Leadership Institute News
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### Events

May 12<sup>th</sup> & 13<sup>th</sup> - Gainesville, Florida - [Tier 2 Training](#)

August 3rd - 5th - Gainesville, Florida - [Tier 1 Training](#)

November 15th - Denver Colorado - Association for Corporate Growth, '*Is there a Profit Gene?*'

## Succession Planning and Profitability

Succession planning and leadership pipelines are a serious issue in corporations today. How can we improve the impact of these programs on enterprise profitability? More importantly, how can we integrate methods for identifying, measuring and developing financial acumen concepts within HR systems so that they can improve their ability to impact enterprise profitability?

We ruminated on this after reviewing a recent article "Making the CFO the Chief Profitability Officer" in Harvard Business School's "Working Knowledge" (Jonathan Byrnes, April 3, 2006, <http://hbswk.hbs.edu/item.jhtml?id=5282&t=dispatch>). The article argues that, in virtually all companies, 30% of the business is unprofitable but that companies keep it since there is no one focus for managing profitability. The result is what the author calls "embedded unprofitability".

"Why assign the role of profitability just to one central person?"

### Budget or Bust

According to the article, in most companies "no-one is responsible for systematically analyzing and improving profitability". While a CEO or General Manager may appear to be responsible, most of their time is

"Many companies are starting to launch

actually spent on other matters. Even if all managers are meeting budget, usually at least 30% of the time

### Promise You'll Save Your Pocket-Money

Which brings us to the two major problems of mid-level SPPs. The first is the same as for their top-level brethren. HR systems still do not integrate goals and measurements for linking them directly with enterprise financial outcome and valuation.

The second is much deeper. How do you assess the potential for a mid-level executive to run a profitable show if he has never even run a P&L?

To put it more clearly, how do you assess the nose for profit and the financial acumen of a mid-level executive if they have never had a chance to demonstrate these capabilities?

Whether our goal is to eliminate embedded profitability or to improve areas that are already profitable, SPPs will only be able to address these issues fully once they can formally identify and measure the financial traits of an executive.

Our view is that this is one of the main reasons for embedded unprofitability, to the extent that we believe it is truly a widespread phenomenon. For executives who have been chosen more for their ability to manage to budgets rather than for their native financial acumen, embedded unprofitability will be accepted rather than challenged.

launch mid-level SPPs."

30%, and often more, of the company's business will still be unprofitable. Most executives, it implies, are trained to manage budgets, rather than profitability.

The author proposes a solution, the Chief Profitability Officer. The CPO is actually the CFO whose role will be revamped. This will help solve the problem of embedded unprofitability, or so argues the article.

Brilliant Pebbles

This got us to thinking. Why assign the role of profitability just to one central person? Or for that matter, six (or whatever other arbitrary number we care to choose)? Isn't profitability the responsibility of everyone in the company, no matter their level and role?

In fact, isn't that what succession planning programs (SPPs) are supposed to do; identify, develop and promote those executives who are best qualified to help in this area? Isn't it the role of SPPs to decentralize and improve the profitability process?

**'The 3 Financial Styles of Very Successful Leaders' by Dr. E. Ted Prince; McGraw-Hill, 2005.**

All of that is true. But there are a couple of important issues in succession planning programs that also impede them from achieving these goals. Let's talk about that for a moment.

Me or My Family?

Traditionally SPPs were aimed at the

Thus, fundamentally, embedded unprofitability is an HR challenge, not just a profitability mapping exercise.

Financial Success-ion

SPPs can have a major impact on profitability. But in order to improve this impact they must have a way to identify and develop the financial acumen of executives. This provides the methodological and behavioral basis for linking HR systems directly to profitability and to enterprise valuation.

Our work (see Prince, E. Ted "The Three Financial Styles of Very Successful Leaders" McGraw Hill, New York, 2005, [www.perthleadership.org](http://www.perthleadership.org)). on the concept of the financial signature™ of executives and its associated impacts on financial performance and valuation represents such an approach. This approach bridges the gap between traditional leadership competency approaches and enterprise valuation outcome.

SPP Means P/E

Modern HR approaches stress that they are focused on achieving enterprise value. The financial signature approach supports this approach by identifying the type and degree of an executive's financial acumen and revealing the financial and valuation impacts this signature is likely to lead to. This provides the basis for a development program to improve the financial and valuation impact of an executive and executive teams.

This approach fills a vital gap in SPPs by incorporating a direct link between

Traditionally SPPs were aimed at the top executive levels, mainly the C-levels and those running large P&Ls. That was where ownership of profitability was seen to be centered.

In these programs, past profitability performance of the executives was sometimes (but far from always, as Ram Charan has recently pointed out, see his article "Ending the CEO Succession Crisis", Harvard Business Review, February 2005, p. 77) taken into account. Other leadership competencies were also factored in.

In the best of such cases (e.g. the GE case), this system worked well. In the majority, it did far less well. This was because HR systems that were used in the SPPs did not themselves integrate goals and measurements that directly linked executive behavior to profitability, largely because such systems have not existed.

So top level SPPs have had a mixed record, This situation persists partly because of the foregoing reason. It persists also because, where profitability metrics are used, they usually have no formal way to distinguish between past profitability performance that is directly due to the executives themselves as opposed to that which was due to others, to the company or to the market environment.

## Profit Universities

The state of the SPP art has nonetheless advanced to the realization that, in addition, SPPs should be pushed down in the organization to senior and middle management and to cost center managers

by incorporating a direct link between HR systems and enterprise profitability at both the senior and the middle levels of management; it allows SPPs to predict the likely financial performance impact of an executive who has never had P&L responsibility.

Further, even for those executives who have, it provides insights as to how much of their past P&L performance was due to the executive themselves and how much due to their organization and the market.

**"This provides the basis for a development program to improve the financial and valuation impact of an executive and executive teams."**

The financial signature approach is consistent with the modern HR view that all executives have a responsibility for profitability, no matter what their formal role. This view incorporates a liberal philosophy of executive action; executives must be empowered to achieve profitability objectives no matter where they are situated organizationally.

This is the philosophical basis particularly for SPPs that are focused on the middle levels of management that are so crucial to building long-term leadership pipelines and the platform for future profitability.

## More CFOs?

So what about the article above and its thesis of embedded unprofitability? We find it somewhat limited in its approach. It's not that we disagree with the conclusion that there is widespread embedded unprofitability. It's what you do about it.

cost center managers.

There were two reasons for this. First these managers also have a significant impact on profitability, even if it is not recorded in their budget centers.

Second, these are the P&L managers of tomorrow, so these managers too need to be nurtured and developed. These are the base of the leadership pipeline pyramid.

Many companies are starting to launch mid-level SPPs. By their very nature these will be much more extensive and more far-reaching than the top-level SPPs since they will affect many more managers. Their potential is therefore far higher in terms of impacting profitability, both in the present and the future. However the penalties for failure will be greater if the programs are not well-managed since any problems will be seen by many more people.

IT'S WHAT YOU DO ABOUT IT.

We don't think broadening the role of the CFO (or for that matter any CXO) is the right response. We do think an appropriate response is spreading the responsibility for profitability more widely. To do this we need SPPs that focus more clearly and formally on financial acumen, particularly amongst those executives who have never had a chance to demonstrate it but will do so in the future.

In this view of succession planning, the new mantra will increasingly be:

**"Every executive is a profitability officer"**

**Recommendations**

- **Broaden the scope of your succession planning efforts to incorporate a formal focus on financial acumen**
- **Include financial acumen training in your executive development programs**
- **Assess financial acumen and financial signature formally as part of your SPPs at both the top and the middle levels of management.**

**Dear Top Executive**



A few more ideas from the Perth Leadership Institute that might just improve your performance as an executive, you and your employees happier, and make your company more valuable.

We are seeing more and more companies launch succession planning programs. Difficult question. Do they work? We raise some deep issues. However, we do show where they have to go to get real credibility.

Our book **The Three Financial Styles of Very Successful Leaders**, published by McGraw Hill provides another perspective on ethics and profitability as you will see below. You can order from Amazon at

[http://www.amazon.com/exec/obidos/tg/detail/-/0071454292/qid=1107024294/sr=8-1/ref=sr\\_8\\_xs\\_ap\\_il\\_xgl14/103-8250033-2772658?v=glance&s=books&n=507846](http://www.amazon.com/exec/obidos/tg/detail/-/0071454292/qid=1107024294/sr=8-1/ref=sr_8_xs_ap_il_xgl14/103-8250033-2772658?v=glance&s=books&n=507846)

and blog us on your reactions, positive, negative and the rest at <http://blog.perthleadership.org>

Any ideas or suggestions? Email us at [newsletter@perthleadership.org](mailto:newsletter@perthleadership.org) or call at (352) 333 3768 or (516) 223 1286. Suggestions and ideas always welcome.

**Ted Prince**



<p><b>Perth Leadership Institute News</b></p> <p>The <a href="#"><u>Three Financial Styles of Very Successful Leaders</u></a> will be available in two more languages: traditional Chinese (used in Taiwan and Hong Kong) and simplified Chinese (used in mainland China). The book has been reviewed by the Business Book Review, as well as being featured by Europe's Journal of Psychology. Our book, <a href="#"><u>The Three Financial Styles of Very Successful Leaders: Strategic Approaches to Identifying the Growth Drivers of Every Company</u></a>, by E. Ted Prince (McGraw Hill. New York) available in bookstores now. You can order from <a href="#"><u>Amazon</u></a>:</p> <p><a href="#"><u>The Three Financial Styles of Very Successful Leaders</u></a></p> <p>We look forward to responses on the <a href="#"><u>Perth Leadership Blog</u></a> where you will also be able to see the responses of others who also have an interest in this area.</p> <p>The Institute has now trained <a href="#"><u>28 consultants</u></a> in PLOM basics and its Financial Signature™ approach. Call us for details of how they can help you implement the Perth approach in your organization.</p>	<p><b>The Financial Signature™ of Leaders and Company Valuation</b></p> <p>Do leaders have personal financial traits that lead their organizations to have a characteristic financial performance?</p> <p>This issue is one that is being researched extensively by the Perth Leadership Institute. It is a crucial area. If it is true, then it opens up a totally new perspective on leadership. It raises the possibility that organizations run by certain types of leaders will have a characteristic valuation trajectory and outcome. That would be a revolutionary finding.</p> <p>Still, with such a new concept, is there any other research which provides some validation?</p> <p>To find out more about this approach and how it can help you increase the financial and valuation performance of your company, see <a href="http://www.PerthLeadership.org"><u>www.PerthLeadership.org</u></a></p>
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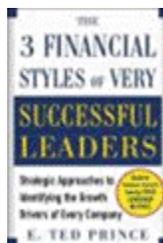


**Now Available**

[The Three Financial Styles of Very Successful Leaders](#)

by [E. Ted Prince](#)

Published by McGraw Hill



The research being conducted by the Institute over the past few years has led to a book. Its title is: [The Three Financial Styles of Very Successful Leaders: Strategic Approaches to Identifying the Growth Drivers of Every Company](#).

This book incorporates a new theory of leadership based on a unique approach. This book develops the concept of a Financial Signature™ possessed by all leaders that drives the outcome, the market value and ultimately the valuation, of the organization they lead.

This book shows that the personal financial traits of leaders impact their organizations through a predictable financial performance. This issue is one that is being researched extensively by the Perth Leadership Institute. It opens up a totally new perspective on leadership. It shows that organizations run by certain types of leaders will have a distinctive valuation trajectory and outcome.

We call the personal financial traits of leaders, the Financial Signature™. This has been a focus of much of our research. The underlying model behind the Financial Signature™ can be operationalized and measured. Our research shows that the Financial Signature does indeed correlate with the financial performance and the valuation outcome of companies and enterprises.

The Financial Signature™ of leaders has wide-ranging ramifications. In effect it links organizational psychology with the theory of the firm. To date, leadership theory has been either based

tional psychology with the theory of the firm. To date, leadership theory has been either based on a clinical psychology approach or a competency based approach. The Holy Grail of leadership theory links these with company outcomes and company valuation. In effect this is a theory that belongs to the emerging field of behavioral economics. Our research into the Financial Signature™ of leaders promises to be a new contribution to this linkage.

**Click on the links to see the reviews!!**



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### About the Perth Leadership Institute

Leadership Solutions™ is a publication of the Perth Leadership Institute, [www.PerthLeadership.org](http://www.PerthLeadership.org).

The Perth Leadership Institute is the developer and marketer of a proprietary leadership system based on its Perth Leadership Outcome Model™. The Institute provides consulting services to organizations that wish to increase the valuation impact of its leadership and staff.

### Link Index

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[http://www.ifma.org/prod\\_briefs/2005/nov/11\\_04b.cfm](http://www.ifma.org/prod_briefs/2005/nov/11_04b.cfm)

#### The Last Word

“In order to succeed, at times you have to make something from nothing.”

~Ruth Mickleby-Land

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