Best Practices for Developing a CFO Talent Pipeline

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Given the CFO's frequent role as the CEO's right-hand man, CFO succession planning has taken on crucial importance for many companies. A rigorous programme will fill the gaps in the top candidates' skill set and help boards avoid pitfalls along the way, CFO succession veteran Suzzane Wood from Russell Reynolds Associates writes in her best practices column.

When one talks about succession in the C-suite, it is usually CEO succession that is being discussed. But high-performing companies pay equal attention to CFO succession for 2 reasons. First, the CFO is often a member of the supervisory board, particularly amongst listed European companies, and serves as the CEO’s right-hand man. Indeed, at many large firms, the chairman, CEO and CFO form an informal triumvirate that sets the tone for how the company is perceived. As a result, the bar for CFO performance is high and it is expected that the CFO will walk in as a seasoned leader with an established track record.

Second, CFO tenure is relatively short, averaging slightly less than 5 years in large listed European organisations. To meet this high rate of turnover, managing the pipeline for CFO succession must be an ongoing process. One reason for this frequency may be that most CFOs enter the role thinking of it as an end in itself but, once there, he or she will likely soon be in demand as a CEO, chairman or non-executive director.

A recent study noted that, amongst large global companies, the percentage of CFOs between the ages of 40 and 49 who also serve as a non-executive director (NED) increased from 29% in 2002 to 42% in 2012.This indicates that demand for financial expertise on boards has enabled sitting CFOs to take NED positions much younger.

Given these factors, and the importance of the CFO role, it is not surprising that large companies are improving in the CFO succession process. According to our analysis, 62% of FTSE 100 CFOs were internal appointments, with similar rates amongst Eurotop 100 and Fortune 100 companies.
Career management is essential

What is it that these companies are doing right? While the specifics of each company's CFO succession strategy is different, we can extract some general best practices from our experience that are applicable to any company, independent of size. In structuring the CFO succession process, it is important to begin with an understanding of the company’s business agenda and future plans, as well as how the finance function is perceived by its internal and external stakeholders.

Next, the structure of the finance team should be considered – whether it could be better aligned to support the business, as well as the strengths and areas for improvement of the function's senior leadership. In most multinational companies, there are 2 primary pools of senior financial executives. The first are those in the central corporate departments such as M&A, IR, corporate controller, tax and treasury; the second are CFOs of the business divisions/units.

By the nature of their positions, each group has its strengths and weaknesses. Those from corporate headquarters will be rich in technical expertise as well as experienced in investor relations and capital markets, but have less hands-on experience with operational management issues. Those heading the financial function at the division level will have P&L experience working alongside the divisional CEO supporting commercial decision-making, but will have less exposure to group issues such as raising capital, investor relations and corporate development transactions.

The solution to this problem is to actively manage the career paths of high-potential financial executives. They should be rotated through a series of assignments (each ideally 3 to 4 years in length) so that by the end, the candidate has gained experience not only at headquarters and as the CFO of a division, but has also served in a general management role, which could entail leading a major cross-functional project (such as developing shared services or business transformation programme) or serving as a divisional CEO. This third element broadens functional skills into business leadership and reinforces the strategic perspective that is expected of a group CFO.

This professional development path takes time. Our research into CFOs of Eurotop 100 companies shows that the average tenure before reaching the CFO seat is slightly less than 12 years; 13% of current CFOs have even spent more than 20 years in the same company.

Note that a thorough rotation programme precludes designating, even by implication, a particular position as being second in line to the CFO or, worse yet, actually using a title such as "Deputy CFO" unless a decision has already been made. Historically, the group controller was often the presumed successor, but this is less the case now that business experience is valued as much as technical knowledge. In any event, candidates need to be evaluated on their entire record, not merely where they happen to be when it comes time to make the selection.

Preparing for succession

While internal candidates' trajectories should be frequently monitored so that they receive the appropriate amount of mentoring and professional development, particular scrutiny is typically given 2 years before the current CFO intends to step down. This presupposes solid communication between the CFO, CEO and the board regarding the current CFO's plans—something boards are more proactively gauging given the number of options their CFO may have.

At that point, candidates should then be placed in positions that will both address any remaining gaps in their development and permit a final evaluation. They should also be benchmarked against external talent to ensure that the next CFO is truly "best in class", rather than merely the best at hand.

It should be noted that, if the pool of internal candidates is found wanting at this point, most companies will find it difficult to bolster. Recruiting a CFO-ready hire from the outside will be hard as few potential candidates will want to leave their current company to enter a contest they may not win. Instead, those hires – which might be from the ranks of the company's bankers, auditors or non-executive directors – must be made far earlier in the process. This is another reason why succession planning needs to be an ongoing concern of the board.

That the CFO's role is tied to the company's strategic plan underscores the fact that succession timing for the CFO doesn't occur in a vacuum, but must also take into account the corresponding timetables of the CEO and chairman. Because a newly hired CEO may develop a new strategic plan, most companies try to avoid appointing a new CFO when a change in CEO or chairman is also on the horizon, preferring to let the most senior position be decided first.

Even if the company has solid internal candidates to choose from, when it comes time to make the final selection they must be put through the same rigorous evaluation process that an outside hire would face. Third-party consultants can be useful here in providing an objective, structured framework. This typically includes formal and informal meetings, 360-degree references and a psychometric assessment including an in-depth interview with a psychologist. In addition to providing a final check on a high-stakes selection, the process often generates on-boarding recommendations to ensure a successful transition and allows the candidate to discuss any concerns he or she may have.

While CFO succession may not garner the same level of public discussion that CEO succession does, high-performing companies know that it warrants an ongoing place on the board's agenda. That attention will ensure that the company continues to have a pipeline of financial executives with the necessary competencies and experience demanded in today's challenging business environment.

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