UNDERSTANDING RISK EXPOSURE: HOW INDUSTRY MOVEMENT CAN IMPACT YOUR ORGANIZATION

Talent Intelligence
Leadership Risk Management

EXECUTIVE SUMMARY

This white paper examines the risks and challenges associated with unplanned executive turnover by charting the immediate impact of a single CEO departure on the pharmaceutical industry and the internal impact of an executive hire at W M Morrison Supermarkets Plcs.. Ultimately, an analysis of the residual effect of both changes reaffirms the prevalence of 'replacement' and not succession planning. Few companies have the requisite bench strength or strategic foresight to curtail the impact of industry movement on an organisation's leadership team.

* A study by Kevin and Edward Coynes of the top 1,000 U.S companies found that an outside CEO appointment quadrupled the average involuntary turnover rate of senior management.

EVALUATING LEADERSHIP RISK

Planned or unplanned, the departure of critical talent can have a profound impact on short, medium and long-term business continuity. A limited pool of leaders have the required skill set to navigate change and facilitate growth on a global scale, and the loss of any C-Level Executive can leave the most well equipped HR functions scrambling to identify qualified successors. The impact an unexpected loss of critical talent can have on a company's bottom line can prompt ill-advised promotions or remit expansions, while months can pass in the search for a suitable candidate. Meanwhile, the demand for particular leadership skill sets and the ongoing talent shortage have intensified the competition for senior executives, with the departure of a single executive having a ripple effect across an industry.

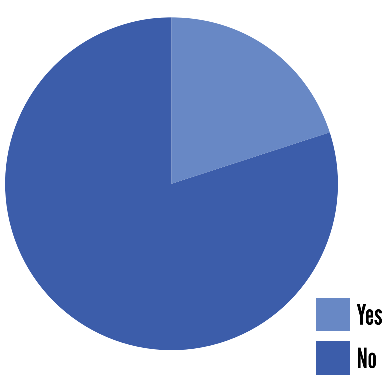
In fact, one departure can radically alter the composition of the leadership team for multiple companies, and even an industry, as organizations routinely use the high potential talent of competitors to address critical vacancies. The subsequent arrival of a new senior executive can further spark a wave of involuntary departures* (an analysis of which can be found on page 6), as new talent looks to assert internal control and establish a formal break from previous leadership. While considerable research has been undertaken to undermine the effectiveness of outside executive hiring, few account for the significant difference between internal replacement planning and "best practice" succession planning. The former is a finite and limited evaluation of internal successors for specific job roles, without consideration for how a role - and its required competencies - develops over time. The latter aims to develop deeper and broader bench strength in those competencies required for different levels of work, and typically integrates internal and external talent benchmarking and pooling.

With the vast majority of external searches reacting to a recent or upcoming executive departure, the timeline of a "replacement" search inevitably constrains the quality, availability and readiness of external talent available.

This approach is becoming increasingly problematic with the general reduction in senior executive tenure, as the ever-increasing transparency that comes with media exposure and the emergence of new economies has led to an ongoing reevaluation of the "successful" leader. Truly successful leaders are now expected to drive change, demonstrate strategic agility, be globally mobile, possess a global mindset, speak multiple languages and deliver immediate and demonstrable results. **The supply of such talent is dwindling, leading to higher demand for a select number of high potentials and an elevated risk profile for those companies that have insufficient bench strength to combat unplanned change.**

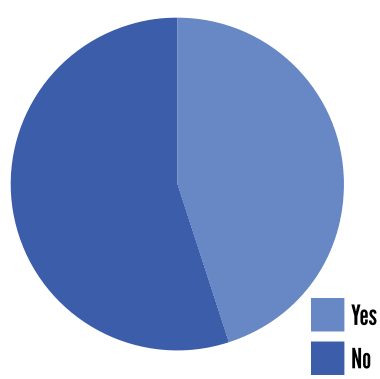
Executive turnover will, in all likelihood, continue to rise over the coming years, as the emergence of "Generation Y" leadership, an ageing talent pool and a global skills shortage will conspire to reduce company loyalty. Many companies already have to address the unplanned departure of high potential employees, as "mobility" and "employability" move past "job security" on personal agendas. However, despite the tenuous hold that companies have on critical leaders, many continue to believe existing attrition rates and employee satisfaction surveys are evidence of low risk profiles. This can largely be attributed to an emphasis on retention and performance risk, as few companies account for the sizable impact that industry movement can have on an organisation's leadership structure. However, as the following analysis will reveal, when the unexpected departure of a CEO at an immediate competitor can provoke disarray amongst your leadership team, that risk profile is likely an inaccurate representation of reality.

Percentage of Managers That Describe Their Bench Strength As "Strong"*



*Statistics courtesy of the DDI.

Percentage of Companies That Have The Right People To Counter Global Change*



* *Statistics courtesy of McKinsey.

THE CASE FOR LEADERSHIP RISK MANAGEMENT

To illustrate this point, as well as the scope of leadership change, Talent Intelligence has undertaken an analysis (a) of an unplanned departure at AstraZeneca during the early stages of 2012 and (b) the secondary impact of a CEO change at W M Morrison Supermarkets Plc (Morrisons). In the case of AstraZeneca, the fallout is significant, spanning four companies, eight role changes and three job types over a period of nine months, as AstraZeneca, Roche, Reckitt Benkiser and Smith & Nephew are all forced to adapt in the wake of significant leadership change. For Morrisons, the appointment of Dalton Philips as CEO would lead to a radical restructuring of the senior management team over a period of 24 months.

Recent executive departures from the likes of Microsoft, Anglo American, Barclays, Rio Tinto, Citigroup and Intel have reaffirmed the immediacy of leadership-associated risk, as even the most high profile employers can find themselves exposed to unplanned change. Such departures will likely impact their associated industries for several more months, as qualified executives pursue new roles and organisations respond by promoting internal talent and conducting external searches.

The widespread nature of planned and unplanned executive turnover begs the question: **"why don't more companies take measurable steps to reduce the impact of unplanned departures?"**

In the sequence of changes identified at AstraZeneca (see change diagram page 7), Roche AG's COO of Pharmaceuticals abruptly left the company to assume the vacant CEO role (formerly held by David Brennan). This unplanned departure provoked two interim promotions within AstraZeneca, two internal promotions at Roche and, finally, an external move on behalf of Smith & Nephew to replace a departed CFO. Had each company identified qualified external talent, AstraZeneca's leadership change would have little-to-no impact on the financial and strategic continuity of the business. Instead, each of the four pharmaceutical companies was exposed to a period of uncertainty that likely had profound financial and strategic ramifications.

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There were a total of eight executive role changes that can be directly traced back to David Brennan's departure.

Ultimately, as the pool of qualified, "ready now executives" continues to diminish over the coming years, an ever-increasing number of companies will be forced to engage internal and external talent on an ongoing basis to mitigate leadership risk. As evidenced by the diagrams on pages 7 and 9, the failure to plan against future turnover can spark the early phases of a leadership "butterfly effect" that significantly impacts an organization's structure. Those companies looking to retain (or obtain) long-term competitive advantage can do so by proactively planning against the unplanned departure of critical business talent.

(A) LEADERSHIP TURNOVER AT ASTRAZENECA, ROCHE AG., RECKITT BENCKISER AND SMITH & NEPHEW: SUMMARY OF FINDINGS

For the purpose of this study, David Brennan's departure from AstraZeneca has been identified as the launching point for subsequent leadership changes throughout the year. Brennan's decision to retire came after weeks of speculation over investor dissatisfaction with existing management, which may have been prompted by Brennan's alleged remuneration increase despite concerns over long-term patent security. Upon leaving the company, AstraZeneca promoted Simon Lowth - formerly the CFO - to interim CEO, with Julie Brown assuming Lowth's CFO role during the search period.

Pascal Soriot, chief operating officer for Roche's pharmaceutical division, was poached by AstraZeneca in August to become Brennan's replacement. Soriot's decision to leave Roche was met with surprise by the remainder of the executive team, who then promoted Daniel O'Day (formerly COO of Diagnostics) to assume Soriot's former role. Roland Diggelmann, responsible for the APAC region within Roche Diagnostics, was announced as O'Day's successor as head of the division.

In the same month as O'Day's promotion, the incumbent CFO at Reckitt Benckiser - Liz Doherty - announced her upcoming departure. The move was allegedly caused by a lack of "cultural fit", though Liz will aid the transition to new leadership through to March 2013. Adrian Hennah, the incumbent CFO at Smith & Nephew, reported his decision to leave the company at approximately the same time, and was announced as Doherty's replacement in the following month (October). Soriot officially assumed his CEO duties in October of

2012, prompting the demotion of Simon Lowth and Julie Brown. Brown, looking to pursue a full time CFO role, announced her decision to leave the company to assume CFO duties at Smith & Nephew (now vacant in the wake of Hennah's surprise departure).

Importantly, this study only evaluates immediate senior executive turnover in 2012, and contains no reference to promotions or departures that almost certainly came in response to these changes. Needless to say, each instance of change will have impacted a number of individuals, teams and projects, and the scope of that impact cannot be accurately reflected in this report. As of March 2013, the full effect of these changes is likely still being felt.

(A) LEADERSHIP BUTTERFLY EFFECT: DIAGRAM I

The chain of events - all occurring in 2012 - that followed Brennan's departure from AstraZeneca reveal that, while most companies do effectively plan against controllable risk, talent risk is deemed to be beyond control. In such cases, the only effective solution is to identify and implement precautionary talent strategies and bench review processes to mitigate the impact of unplanned change to business continuity.

AstraZeneca

April: David Brennan, CEO, retires under pressure from investors.

May-October: Simon Lowth, incumbent CFO, appointed interim CEO. To resumer old role in October.

May-October: Julie Brown, VP Group Finance, appointed interim CFO, would step back down and depart in October.

August-October: Roche's COO of Pharma, Pascal Soriot, announced as Brennan's successor (to start in October).

smith&nephew

September: Adrian Hennah announces departure from CFO role.

November: Julie Brown appointed as Hennah's successor following October departure from AstraZeneca.

Reckitt Benckiser

September: Liz Doherty, CFO, announces upcoming departure.

October: Adrian Hennah annouced as Doherty's sucessor.

Roche

August: Pascal Soriot, COO of Pharma, announces departure from Roche AG.

September: Daniel O'Day, former COO of Diagnostics, named COO of Pharma.

October: Ronald Diggelmann, former head of APAC Diagnostics, announced as O'Day's successor.

(B) CEO TURNOVER AT W M MORRISON SUPERMARKETS PLC: SUMMARY OF FINDINGS

Dalton Philips, formerly COO at Loblaws, was appointed the new CEO of Morrisons in January 2010 to replace the departed Marc Bolland. Bolland had announced his departure in November 2009 (effective as of February 1st, 2010) in order to join competing retailer M&S. The decision to appoint Philips was met by surprise by many, as the incumbent Finance Director, Richard Pennycook, was regarded by many as a likely successor to the role.

Philips executed his first significant change to senior management in January 2011, promoting Richard Lancaster to the role of Marketing Director to replace Angus Maciver (who would leave the company shortly thereafter). A second wave of changes were made over the course of 2012, as Norman Pickavance, the company"s HR Director, and Richard Lancaster, then Corporate Marketing & Operations Director, both stepped down from their positions in April. Karen Caddick would be promoted from within in order to replace Pickavance (who would join Poundland as a Trading Director), while Nick Collard, formerly the group's Grocery Director, took over the Marketing and Operations Director role. In January
2012 he was promoted to Group Marketing and Customer Director and Rebecca Singleton was poached from Sainsburys as the new Marketing Director, reporting into Nick Collard.

In June 2012, Richard Pennycook, the company's longstanding Finance Director, announced his impending resignation. Pennycook's departure came as a shock to many, though he will remain with the company until June 2013. To replace Pennycook, Morrison's has promoted Trevor Strain, a senior manager in the finance department. In October the company announced the upcoming departure of the Commercial Director for Non-Food, Mike Snell. Mike was replaced by Lisa Maio, who was selected internally. Just one month later, the group's Commercial Director, Richard Hodgson (one of Philips" first appointments as CEO) announced his imminent departure from the company in the face of worsening sales figures. Martyn Jones, Corporate Services Director, was named as Hodgson's interim successor later in the month of November.

Finally, in January of 2013, Morrisons' Company Secretary, Greg McMahon, announced his departure to take on a new role at Mitchells & Butler plc. Morrisons has appointed Mark Amsden, a partner at law firm Addleshaw Goddard, to succeed McMahon. McMahon's departure marked the sixth change to the company's senior management team in a twelve-month period.

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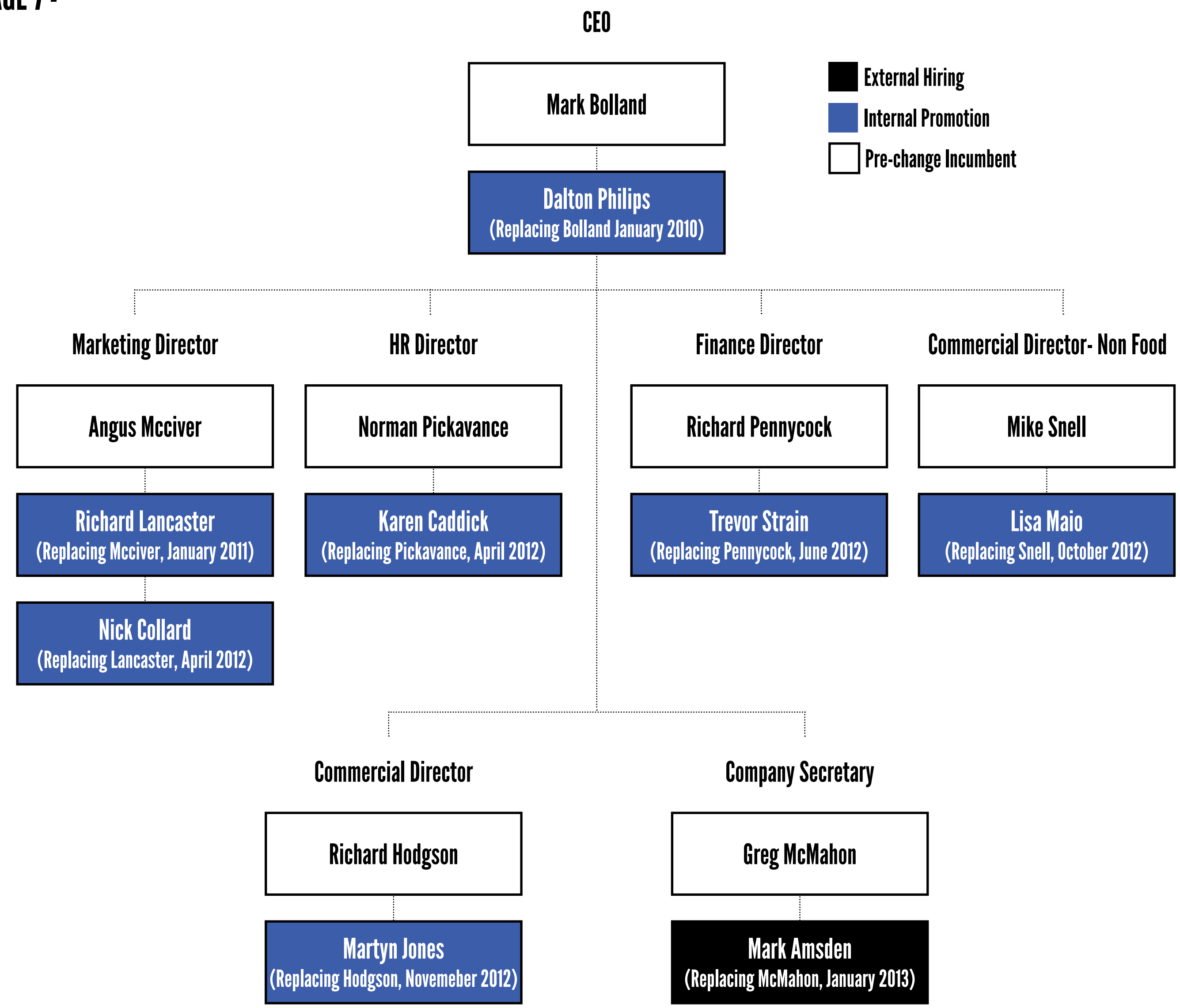
McMahon's departure in January 2013 marked the sixth change to the company's senior management team in 12 months.

(B) LEADERSHIP BUTTERFLY EFFECT: DIAGRAM II

While not all of these changes can be solely attributed to the arrival of Dalton Philips, the gradual reshaping of the senior executive team is indicative of many of the residual changes that often come in the wake of a new CEO appointment. (The diagram below is representative only and does not necessarily represent a reflection of the board structure and reporting lines).



CONCLUSION

Planned or unplanned, the departure of a senior executive typically entails a protracted search period that disadvantages a company until a qualified successor has been appointed, and transitioned, into the vacant role. By way of an example, Intel's current CEO, Paul Ottelini, has only recently announced his impending departure in May 2013, at which time a six month search will be undertaken to identify his successor. Similarly, Cynthia Carrol's unexpected decision to exit Anglo American has prompted an internal and external search process that is projected to last six months.

While AstraZeneca, Reckitt Benckiser, Roche AG and Smith & Nephew have all been exposed to varying levels of risk as part of such a search process, each has had to react - perhaps impulsively - to an unplanned change. In addition, each new appointment will be followed by a transitional period that may handicap day-to-day production. In short, while the immediate financial and strategic impact of such a change is, at this stage, purely speculative, all have experienced an unnecessary threat to business continuity.

Going forward, the HR function will increasingly bear the weight of such changes, and thus be expected to implement robust and dynamic strategies for managing leadership risk. The traditional
"replacement planning" approach to managing bench strength will be inadequate for those companies looking to obtain competitive advantage for the medium-to-long term, as the prevalence of duplicate successors (the pipelining of more than one high potential individuals for multiple roles) will routinely expose companies to leadership risk. Only those undertaking dynamic "succession planning" activities will be equipped to address leadership change with the requisite speed and efficiency to remain competitive. As this report has demonstrated, existing strategies often fail to acknowledge the widespread impact that a single departure outside the business can have on one's leadership team.

At a minimum, the impact of David Brennan's departure should provoke a frank internal assessment of current bench strength and, more importantly, the readiness of developing talent to facilitate growth in the event of an unplanned departure. However, few are identifying and developing talent in a way that anticipates the future needs of the business, and this oversight - coupled with the impact of senior leadership departures - unnecessarily exposes companies to substantial business risk.

CASE STUDY

Our client, the world's leading provider of mobile software and solutions, already had a robust internal succession plan led by their Head of Global Talent. They had identified forty roles that were critical to the success of their business and delivery of their strategy, particularly as they were undergoing a major business transformation process.

However, they were also aware that they had little sight of the external talent market for these top forty roles. Working with Talent Intelligence, they now have established relationships with top leadership talent globally with complete visibility of both their internal and external succession pools, as well as a more strategic approach to managing their forty key "at risk" roles.

Already this has reduced the time to hire an external candidate to signed offer within thirty days of the vacancy and a return on investment of more than $240,000 in one year. For them, this was about knowing and understanding their market and the key players within it, to attract and build relationships with future leaders, and to reduce the business risk associated with the loss of a key individual so that the impact - internally and externally - was minimized. They now have real time benchmarking of external candidates that, in addition to being aligned with their strategic direction, has been adapted in order to reflect the composition, structure, and performance of their own leadership team.

If an unplanned vacancy arises in the future, our client is no longer restricted to looking at internal candidates and/or picking up the telephone to an executive search firm. Imagine having complete visibility of all potential successors both internally

[Our client] has established relationships with top leadership talent globally with complete visibility of both their internal and external succession pools...

and externally – on demand – on a continuous basis. Imagine having already met the possible external candidates "just in case"; imagine a fill time of less than two months or better, and imagine a best practice approach where real return on investment is proven through a proactive, strategic approach to leadership risk and succession planning.

Talent Intelligence solves its clients' critical talent challenges through the integration of external succession planning, talent pipelining, and competitive intelligence. All intelligence is securely stored so you can access it on demand and integrate it into your company's existing workforce planning process. Our Intelligence Delivery Teams flag high-potential candidates, bringing them directly to your attention, so when the time is right, we can facilitate a networking engagement between you and any candidate of interest.

By working with Talent Intelligence, our clients maintain a 360-degree field of vision over the talent marketplace. Our service enables companies to:

- Continually map talent outside of their organization
- Identify key players, top performers, and rising stars
- Network with select candidates to measure fit and interest
- Build informal relationships with high potential individuals
- Integrate those individuals into their workforce planning

Our core product offerings include:

Succession Intelligence: Transition smoothly when you implement your succession process by integrating the competition's talent into your succession planning.

Pipeline Intelligence: Access top quality executives for critical openings when you need them by identifying the best candidates for critical roles ahead of demand.

Competitive Intelligence: Retain your top performers and recruit your competition's rising stars by spotting trends and anticipating industry events based on intelligence directly from the competitions' workforce.

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About Talent Intelligence

Talent Intelligence is a global leadership risk management company that solves its clients' critical talent challenges by integrating external talent intelligence in four key areas: succession planning, talent pipelining, diversity intelligence and human capital competitive intelligence. All intelligence is securely stored so clients can access it on demand and integrate it into their existing workforce planning process. Our Intelligence Delivery Teams flag high-potential candidates, bringing them directly to our clients' attention — so when the time is right, we can facilitate a networking engagement between you and any candidate of interest.