

Transition Risk: The Silent Killer



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Risk is a hot topic. In fact, corporate boards are inundated with information and advice about how to mitigate strategic risk, operational risk, credit risk, cyber risk, reputational risk, legal and regulatory compliance risk, consensus risk and more.

Risk, however, increases exponentially during times of transition, but transition risk is seldom—if ever—specifically addressed.

1. *Expected transitions* include management succession, acquisitions or divestitures, entry into or withdrawal from specific markets, new product introductions or withdrawals and/or implementation of new systems.
2. *Unexpected transitions* include circumstances such as sudden incapacity, death or departure of the CEO, the CEO failing to meet expectations, exposure of wrong doing by a key executive, unanticipated introduction of a game-changing technology or competing product, exposure of a product flaw, a natural disaster that disrupts corporate and/or customer operations and needs, a sudden and dramatic deterioration in revenues caused by an unexpected market change, a major customer or supplier going out of business or being acquired, a cyber breach, technology failure or sudden change in the market's perception of the benefit or harm provided by a company's products and services.

Below are three different but common situations that illustrate the damage that can occur when boards fail to ensure that management responds effectively to transitions. In the first two, the transitions proved deadly. In the third, the company was hobbled for an extended period of time.

1. *An expected transition:* Internationally recognized family business consultant, Dr. Lee Hausner, author of "The Legacy Family," reported multiple examples that are all too familiar to every professional who has worked with family-owned businesses.

a. What happened: Companies failed because their boards of directors—for a variety of reasons—allowed the wrong family member to lead the company into the next generation.

b. What should have happened: Those boards needed to take steps to see that issues relating to succession were addressed in a timely fashion; e.g., specification of a process for selecting the next leader, adoption of selection criteria and implementation of a system to ensure accountability during and after the transition.

2. *A transition that could have been and should have been anticipated:* Multiple privately held companies that were suppliers to the construction industry in the Pacific Northwest failed in and around 2009.

a. What happened: In early 2006, when the housing market was still going strong in the Pacific Northwest (PNW), national news media began reporting a real estate downturn in other parts of the country. These reports, as well as the number of locales affected, multiplied throughout the next two years as the downturn marched across the country. Too many PNW housing industry suppliers ignored the signs and assumed that, "It won't happen here." They failed to make plans in case their assumption was wrong.

b. What should have happened: Board members of those privately held companies should have required answers to these questions:

i. What do you currently know about this possible transition?

ii. What impact might it have on company operations and shareholder value?

iii. How are you monitoring and/or preparing for this situation?

iv. If this possible transition becomes reality, how will management and the board know whether plans are on track

and, if not, whether management is taking suitable corrective actions?

3. *An unexpected transition*: Salvatore Melilli, national audit industry leader, Private Markets for KPMG LLP in New York, shared the story of an unexpected CEO departure.

a. What happened: A corporate CEO—suddenly and without warning—resigned his position for personal reasons. The company, caught unprepared, had no succession plan in place, no systems in place to address personnel and operational disruptions across its more than 70 operating units and failed to turn to outside professionals who had expertise to ease the transition. The result? Although the company did survive, Melilli observed, “They were in fire drill mode, walking in sand until it was sorted out, with overall focus stagnant for an extended period of time.”

b. What should have happened: Clearly, long before this happened, the board should have insisted that the company have a CEO succession plan in place as well as systems, processes and procedures that would facilitate an effective transition throughout the company.

The above examples illustrate why the ideal board of a privately held company includes at least one director who has experience managing and mitigating transition risks—both expected and unexpected. What attributes should such a director possess?

1. Demonstrable experience successfully navigating transition risks in multiple rapidly changing environments in which quick, effective responses were required
2. Personal business antennae that are finely attuned to detecting transition risks as a result of having lived through a variety of challenging situations
3. Skills to suggest tools to solve unexpected problems quickly
4. Willingness to insist that such issues be considered at the board level, to ask: *What could go wrong? If it does, how do you plan to address it? What are the dangers of NOT addressing this risk?*
5. From Melilli: Courage to say, “Let’s fix the roof while the sun is shining—not wait until it rains.”
6. From Hausner: “In addition to other expertise, board members of family businesses—especially those facing transitions—need to be sensitive to

family dynamics and interpersonal relationships.”

Although corporate boards may have appropriate committees and committee charters, there is no substitute for having board members who continually scan the horizon to see what others miss, who address not only the topics that are on the agenda but also the topics that ought to be on the agenda and who know how to respond to the unexpected.

Transitions can be deadly because risk increases exponentially at times of transition. Does your board have at least one member who is qualified to help minimize such risk.

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